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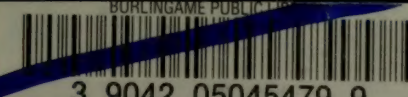
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January 14



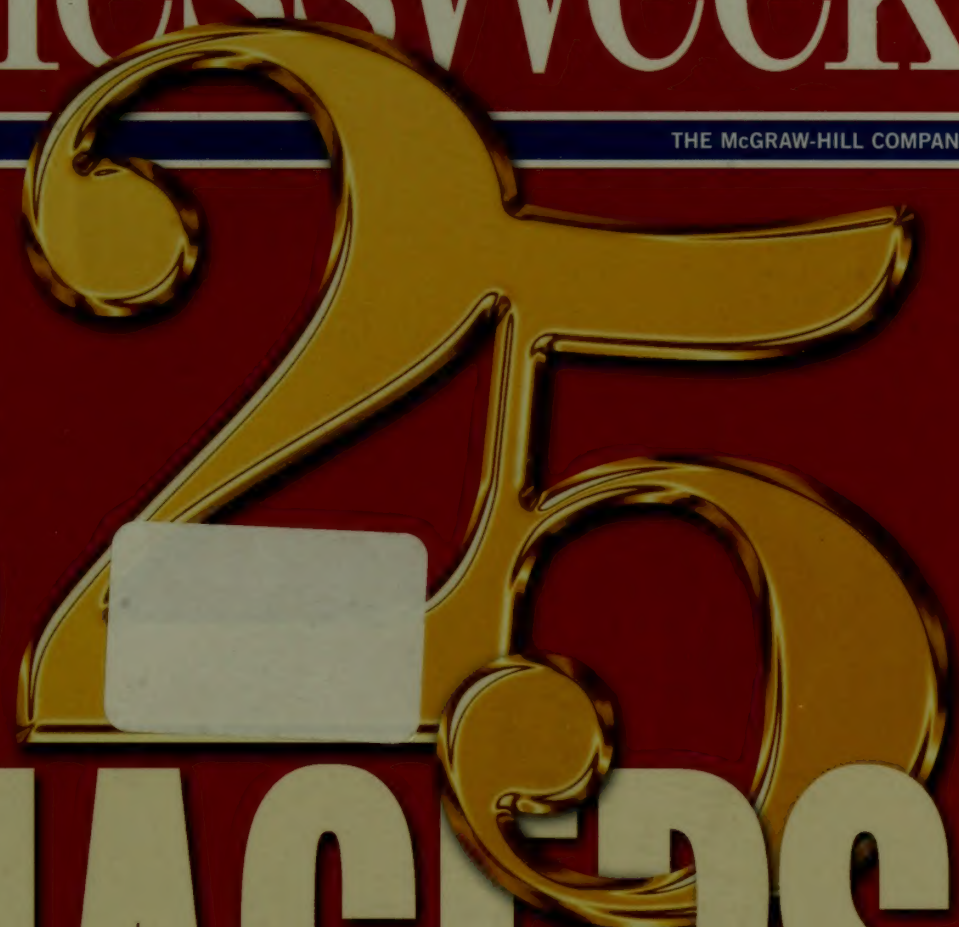
ERICA'S KEY



BusinessWeek

14, 2002

THE MCGRAW-HILL COMPANIES



THE TOP MANAGERS OF THE YEAR



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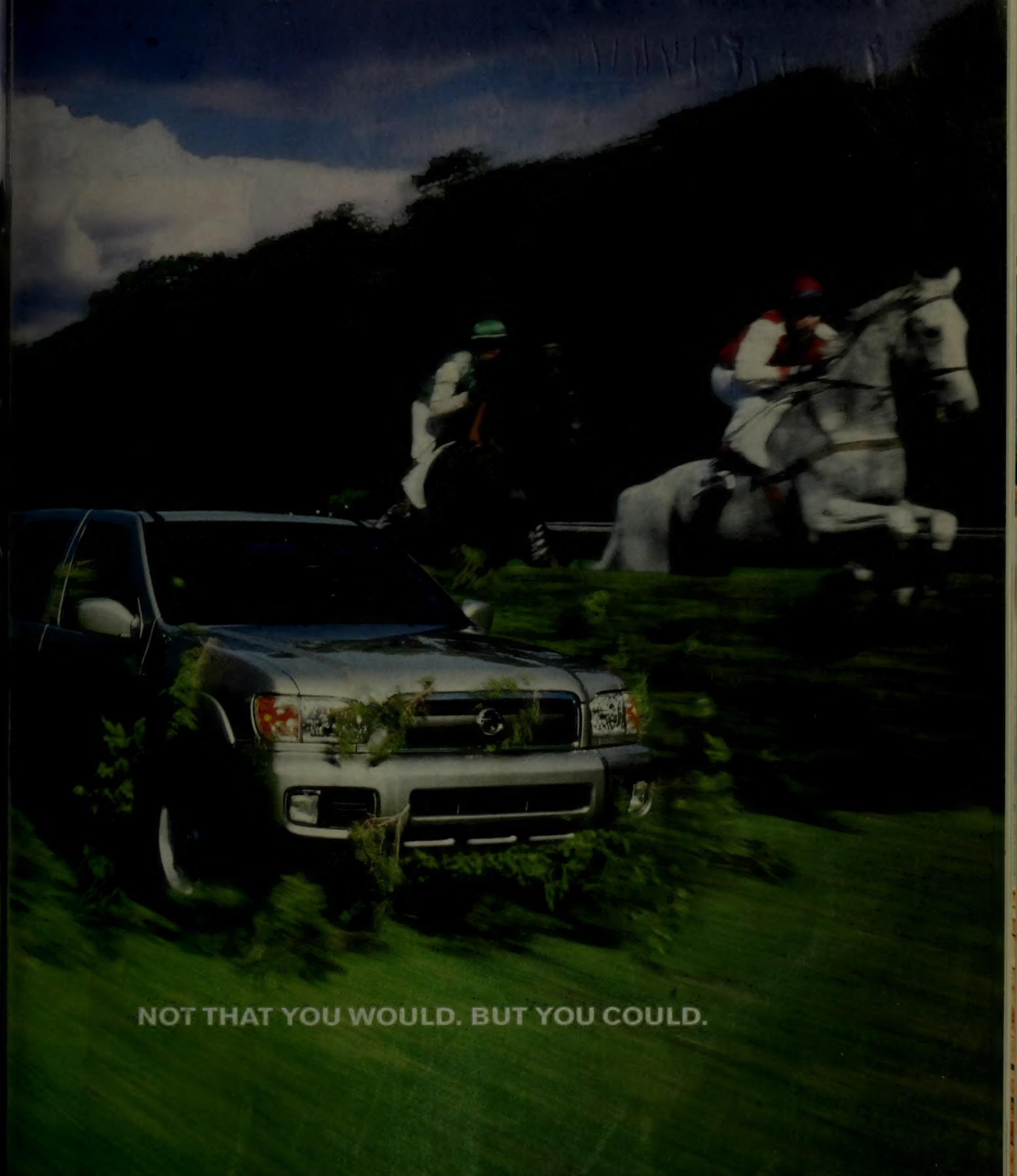
PLUS: Managers to Watch
The Top Entrepreneurs



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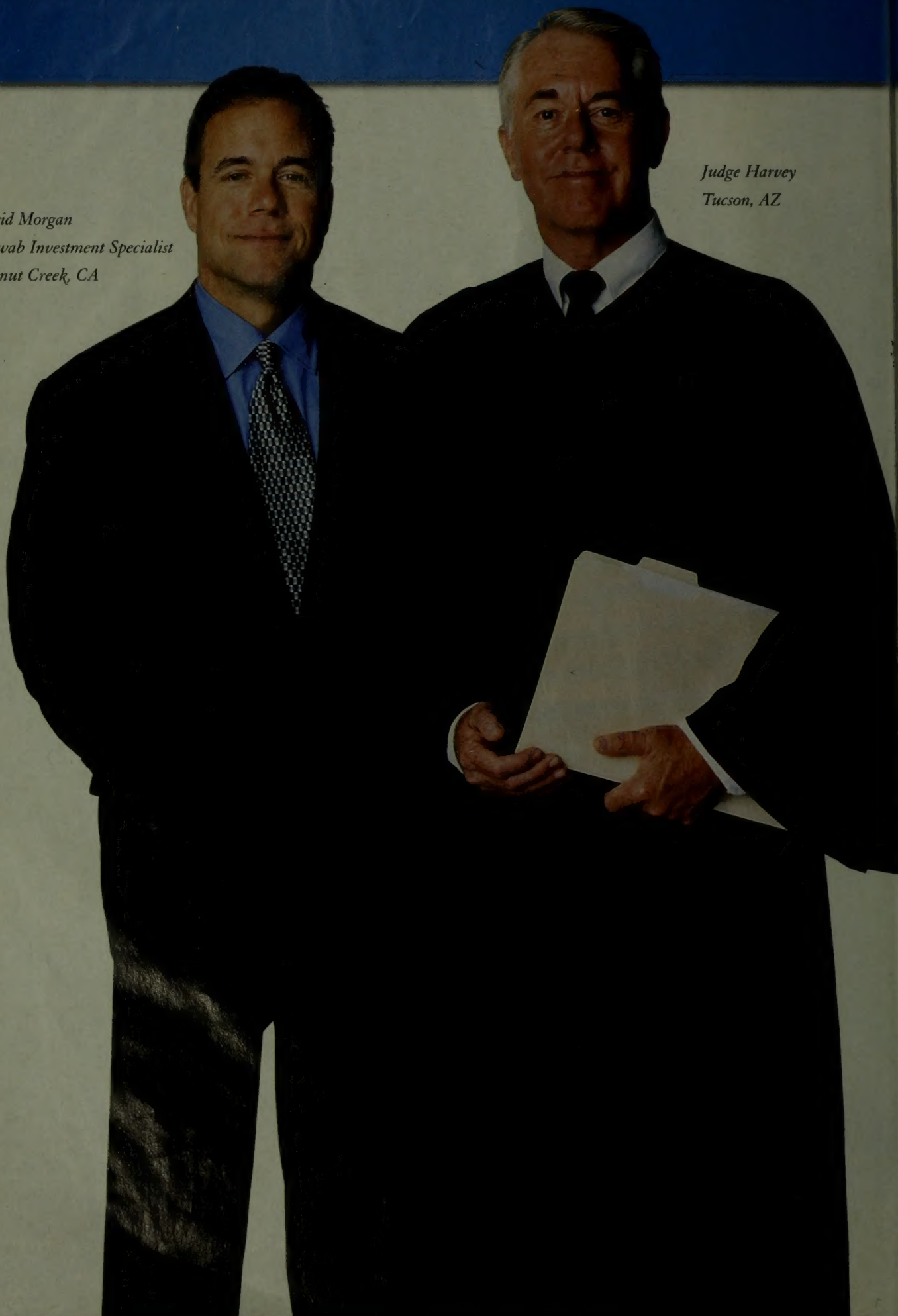


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Schwab Investment Specialist
Walnut Creek, CA

Judge Harvey
Tucson, AZ



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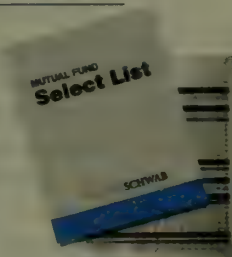
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BusinessWeek

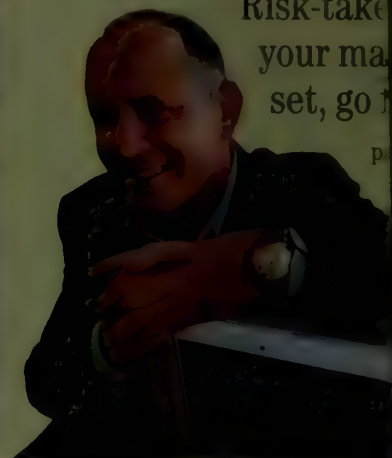
JANUARY 14, 2002

COVER STORY

THE TOP 25 MANAGERS
Recession, terrorism, war
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took on new meaning,
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strategies to the times

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Risk-takers
your market
set, go for
it



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INDUSTRY OUTLOOK 2002

PRODUCTION

INDUSTRY OUTLOOK

It'll be a recovery with a small "r," and patience will be a virtue for company and investor alike

MANUFACTURING

AUTOS

The hangover from the 0% financing party will mean first-half queasiness

CONSTRUCTION

Builders may finally hit the wall after a decade of prosperity

AEROSPACE & DEFENSE

Commercial wings are clipped, but military planes could take off

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Original streaming video featuring industry experts and BW editors

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BW's Bruce Nussbaum on how 2001's turmoil is changing attitudes for the better



DIVIDEND PLAYS:

With money market rates so low, these stocks are attractive again, says BW's Margaret Popper



TOOLS

YOUR PORTFOLIO:

Check on the health of your investments



STOCK SCREENER:

Use more than 70 criteria to pan for gold among the equities



MBA SEARCH: Which is the right business school for you and your needs?



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Tech's Future

Want to see what 2002 has in store for technology companies? Start by looking back at these key events of 2001—from big bankruptcies to September 11



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Street Wise: The top generic-drug makers can offer something rare these days: Steady growth



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Q&A: Which sectors could shine in 2002? BW's Jeff Laderman points to energy, along with finance and real estate

SMALL BUSINESS A resource for entrepreneurs

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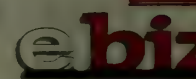
Factory Days: In the U.S. and in Asia, being a woman small-business owner has its challenges



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OVER THERE

THE EURO: A SHOPPER'S BEST FRIEND

EUROPEAN CONSUMERS ARE GETTING SOMETHING OF A BANG FOR their euro these days. On New Year's Day, 12 countries began using euro notes and coins. As had been hoped, there were long bank lines as customers waited to exchange currency. But the expectation that prices might rise as they change from francs, marks, pesetas, and all the rest was confounded. Many merchants are effectively lowering prices.



DAY ONE: Prices were streamlined

for 24.99 euros. The savings grow for larger purchases. Aldi, a German discount chain, used the euro's arrival to cut prices an average of 3%. And with cross-border price comparisons now easy, stores feel more pressure to hold down prices. Says an Aldi spokesman: "We can source our products more cheaply, and we'll pass on the benefits to the consumer." Generally, consumers seem pleased. And why not, when the new currency buys more than the old? *David Fairlamb*

NUMBERS GAMES

FUNNY BUSINESS 101 GETS A NEW SPIN

COULD IT BE A SIGN THAT accountants' numbers games are going out of fashion? Since last spring, a two-day \$995 accounting course had offered tips on "slight[sic]-of-hand and revenue reporting" and "nine ways to say earnings," while warning that "accountants who lack this critical skill may be destined for a life of number-crunching instead of a corner office." Run by the National Center for Continuing Education in



Tallahassee, the courses drew hundreds.

But Enron's fall has highlighted the risk of clouding such numbers, so the firm's pitch is changing. Executive Director Joseph Weil says a new brochure promises a case study of Enron and "Tricks-'n'-traps auditors should be aware of." There is still plenty to teach that can pass SEC muster, adds Weil. "At no time do we tell people to break the law. It is not [about] how to cook the books."

That's a relief: The National Association of State Boards of Accountancy says that the firm's courses count toward the continuing education requirements for a CPA. *David Henry*

TALK SHOW "This wasn't exactly the response we intended." —William Fitzsimmons, Harvard's dean of admissions. Some e-mails telling applicants if they had been admitted never arrived because AOL interpreted them as junk mail



INVESTOR BEWARE

WHEN EXECS PROTEST TOO MUCH

WHAT CAN INVESTORS BELIEVE? Institutional research is often way off the mark or sullied by analysts' cozy ties to their investment-banking colleagues. And earnings reports are increasingly convoluted. So we've developed the "Trash Talk Indicator," or TTI. It's simple—when you hear execs publicly trash an analyst's research, sell. Usually it's a sign that the analysts are hitting close to home.

We know the Enron case, of course: Former CEO Jeffrey Skilling called an ana-

lyst questioning its accounting an ass—in an conference call. Enron filed for bankruptcy. [Skilling] says Skilling was irritated because the analyst was a known short seller using the call to drive down the price.]

There are other cases. Qwest Communications' Joseph Nacchio held a special conference call in July to blast two Morgan Stanley analysts who issued a negative report. He called them "unprofessional" and "irresponsible." However, Qwest's stock dropped more than 50% in the next five months. Nacchio has blamed that on the poor economy.

A year earlier, Amazon's Jeff Bezos labeled a Lehman Brothers analyst's research "hogwash." Amazon's stock price halved in the next months as that analysis and poor cash flows worried investors. [Amazon maintained the analyst was, and still is, wrong.] Nonetheless, there's a lesson here for stockholders ahead of a falling stock price. When the executives rush to sell. *Heather Timmer*

THE LIST BIGGEST BANKRUPTCIES OF 2001

Enron earned the dubious distinction of making the nation's largest-ever bankruptcy filing. Here are some other whoppers.



COMPANY	DATE	ASSETS (BILLION)
ENRON	Dec. 3	\$63.3
PACIFIC GAS & ELECTRIC	Apr. 6	21.5
FINOVA GROUP	Mar. 7	14.1
RELIANCE GROUP HOLDINGS	Jun. 12	12.6
FEDERAL-MOGUL	Oct. 1	10.2
COMDISCO	July 16	8.8
ANC RENTAL	Nov. 13	6.3
360NETWORKS (USA)	Jun. 28	5.6
WINSTAR COMMUNICATIONS	Apr. 18	5.0
PSINET	May 31	4.5

Data: BankruptcyData.com

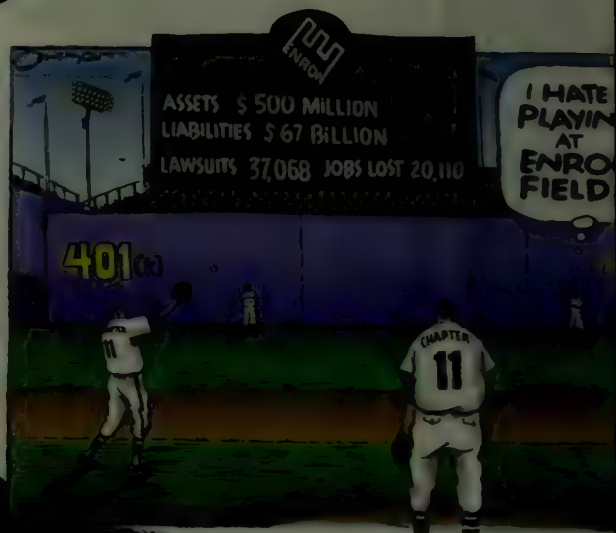


People issues are complex. Managing them doesn't have to be.

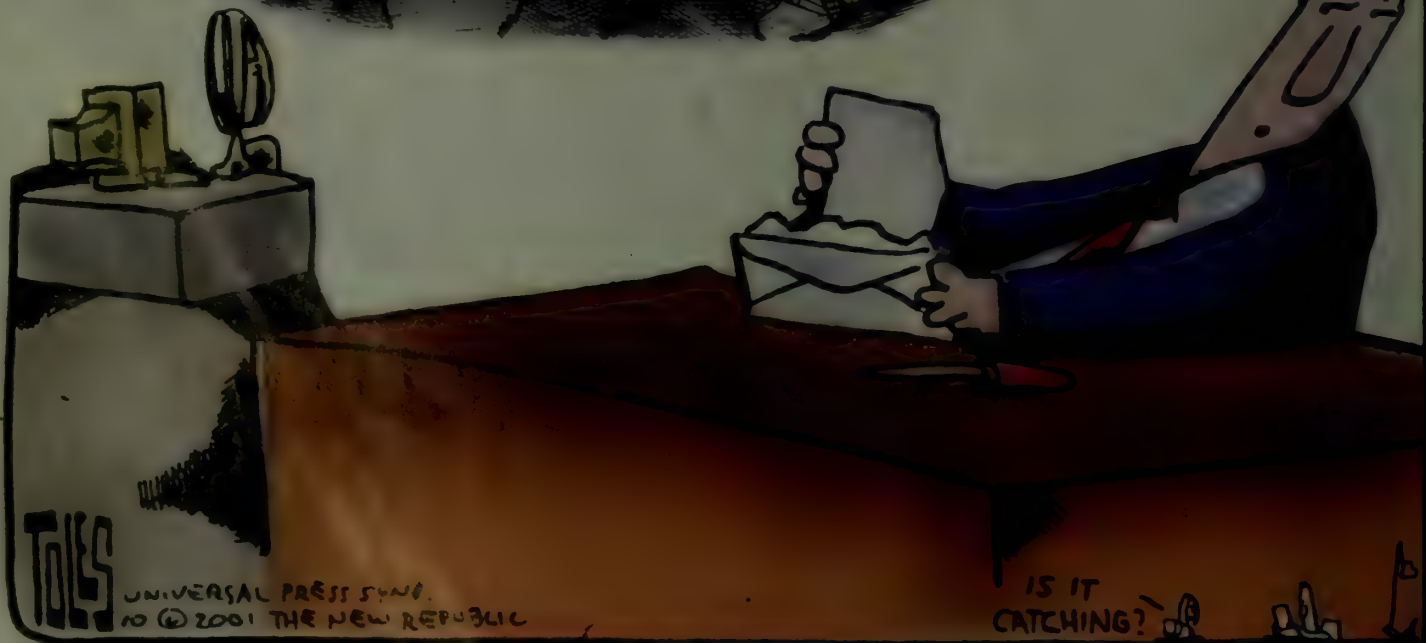
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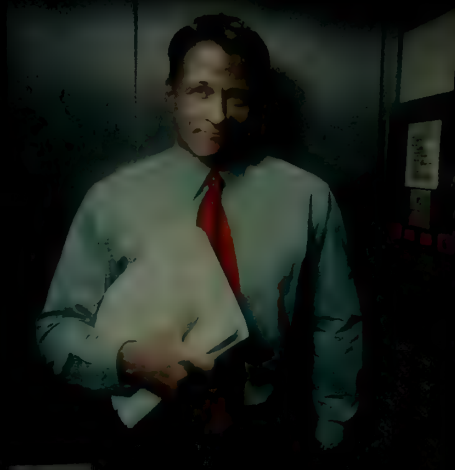


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Software quality ↑ 80%
Developer productivity ↑ 300%
ROI ↑ 1400%

Testing time ↓ 95%
Development cycle ↓ 66%
Lump in throat ↓ 100%



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THE ENRON FIASCO: SO MANY LESSONS

The failure of Enron ("The fall of Enron," Cover Story, Dec. 17) is every bit a failure of the U.S. financial community, which supported the growth story of the company with loan commitments, favorable research reports, and leaky accounting practices. In all cases like this, the enthusiasm for big gains outweighs the need to provide fundamentals.

If discipline were enforced at early stages, Enron Corp.'s fall would have been from a much lower level of credit and market value, perhaps to the extent of not deserving your cover space.

Gary Walther
Winnetka, Ill.

"The fall of Enron" provided real insight. Having once been described in the press as a guru, I sympathize with the four experts you quote in the panel "Everyone loved Enron." The issue is not that none of them could have predicted Enron's demise but that they had all praised Enron at a specific point in time under specific market conditions without the aid of due diligence.

Just as climate change made the most successful predator on this planet—the Tyrannosaurus Rex—extinct, a change in the business climate made Enron extinct. New models have been suggested that allow a more accurate prediction of the inevitable changes in the business climate, and these would have helped Enron.

It is not skillful to predict success or failure; it is skillful to know when the risk of both is at its peak.

Gerald Michaluk
Glasgow

Enron had estimated that the electronic market for bandwidth would reach \$450 billion by 2002, a value comparable to many established markets. Analysts and scholars doubted the model initially, but soon suppressed their doubts. Enron's supporters claimed only a fool could reject such an opportunity given economic theory stating that big markets emerge spontaneously.

The moral of Enron's story is that carefully orchestrated hype can lead to a suppression of counter opinion, to self-serving market forecasts, and ultimately to a loss of shareholder value.

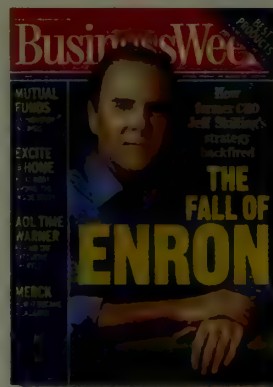
Rado Koto
New York

One way to analyze the expected corporate failure is to ask: Did management tell us about the risks?

Other is to ask: Did the audit committee and the outside auditors understand the company and its risks and ensure the financial reports clearly explained the risks? The Securities & Exchange Commission and others have pointed to the audit committee and the auditors to protect the interests of the investing public. Cases such as Enron may promote further efforts to enhance the oversight of companies' financial reporting processes.

Dana R. Herman
Kennesaw, Ga.

How ironic for those of us in mid-management that in a culture famed for a brutal ranking process, designed to extract maximum performance from the general workforce, senior management was unable to make hard choices about spending and investment decisions. Simply claiming that an industry was ripe for the "Enron Way" was enough to



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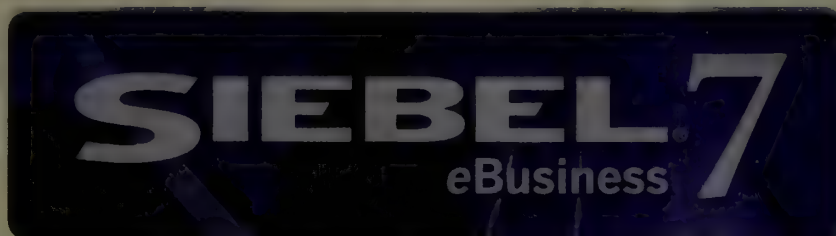
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*Mike Lawrie, Senior VP and Group Executive, Sales and Distribution,
IBM Corporation, November 2001*

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Clemens Kaiser, Head of eCommerce, Bayer, October 2001

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Bruce Richardson, AMR Research, October 5, 2001

"The *dominant force in the industry* is *Siebel Systems, Inc.*"

New York Times, October 1, 2001

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Readers Report

CORRECTIONS & CLARIFICATIONS

In "It could be tech time again" ("Where to invest," Cover Story, Dec. 31/Jan. 7), the final paragraph of the story was incomplete, and should have read: "In the fourth quarter, many investors have become more afraid of losing out on a big rebound than of overpaying for technology stocks. That lack of caution could cost them big in the coming months, if the pessimists are right."

In addition, the "For the record" box accompanying the story should have said that Paul H. Wick runs the \$6 billion Seligman Communications & Information Fund.

"How to cash out of your company" (BusinessWeek Investor, Oct. 1) incorrectly stated that the net unrealized appreciation rule (NUA) requires individuals to take a distribution of their entire balance from tax-deferred plans within one year from when they leave their job. Individuals need not take distributions when they leave a company, but to qualify for NUA they must take all distributions within a year of taking the first one.

tain a blank check from management. Hiding the extent of this activity off the balance sheet simply proves that many executives weren't the masters of the business world they supposed themselves to be, but were simply out of their depth.

Stephen Schwarz
Houston

BusinessWeek's article was very enlightening, except it lacked the suggestion that Enron's top executives might have been emboldened in their questionable (and timely) disposition of their Enron stock by their strong political ties. They must have been pretty sure the SEC wouldn't come after them.

James E. Patterson
St. Louis

If there is any justice in the world, Jeffrey Skilling and his cronies will be held accountable for their malfeasance, their assets will be seized, and they'll be thrown in jail where they belong. I'm not naive enough to think that will actually happen, though. Quite the contrary, I'm sure it's only a matter of time before they're all back within the ranks of highly paid corporate executives.

Oh, and one more thing—*BusinessWeek* and others in the business and financial press are not without some responsibility in this sordid affair.

Joseph Moran
Somerset, N.J.

In your Feb. 12, 2001, cover story ("Power broker"), Skilling is quoted saying, "I've never not been successful in business or work, ever." Oops!

Usamah Zaid
Houston

HOW TO CUT THE COZY TIES THAT HELPED BRING DOWN ENRON

Your editorial, "Enron: Let us cut the culprits" (Dec. 17), completely missed the mark. The accuracy and adequacy of Enron's external financial statements is primarily the responsibility of the management of Enron, not that of the external auditors. Collusive behavior from senior executives, supposedly intended to deceive auditors and third-party users of financial information, cannot be regulated out of existence with the passing of new accounting rules or the stroke of a pen.

We must reinstate the historical relationship of the finance organization to the corporation scrutinizing the operations branch of the company: Eliminate the present practice of having the CEO report to the CEO and restrict CFOs and other high-level finance officers from being paid bonuses based on the company's quarterly or annual results. Also propose that any company requiring an SEC audit must change auditors every three years, and retain the same auditor but once every nine years. That way, there would be at least three separate auditors of a company's financial statements during a rotation.

Gregg M. Stieber, CEO
Sammamish, Washington

EXCITE@HOME AND AT&T'S COMMON PROBLEM: ARMSTRONG

Now, let me understand. The company had a flawed acquisition strategy. It had unrealistic, grandiose plans; it overpaid for acquisitions. It would not raise prices to provide much-needed revenue. It has to sell off acquired assets for less than it paid for them. And, ultimately, employees and shareholders are being stabbed in the back ("Excite@Home: A saga of tears, greed, and ego," Information Technology, Dec. 17). Are you talking about Excite@Home or AT&T? Maybe both companies have the same core problem: C. Michael Armstrong.

Armstrong's expensive broadband/long-mile strategy for AT&T was unrealistic from the start. Had he instead used the money to create the ultimate wireless company—prices as low as land-based telecom, unrivaled reception, and a wireless phone in every hand—he might not

earing AT&T apart today. You know, Armstrong, Bill Gates did pretty well with his concept of a PC in every e, and "air" can be that last mile.

Richard DeLio
Ramsey, N.J.

FDA DOES REVIEW MISLEADING DRUG ADS

Our editorial "How to control drug ads, simply" (Dec. 10) suggests that the Food & Drug Administration should knock down on "misleading" ads. The FDA apparently is unaware that, despite a lack of statutory authority (and, in fact, a specific legislative prohibition), the FDA already does review virtually all consumer ads in advance on a "voluntary" basis on the part of industry advertisers. By law, all such advertisements must be submitted to the FDA before they have aired or been printed. Our research on consumer advertising suggests a benefit to patients.

Jack E. Angel
Editorial Director for Healthcare Communication
Greenwich, Conn.

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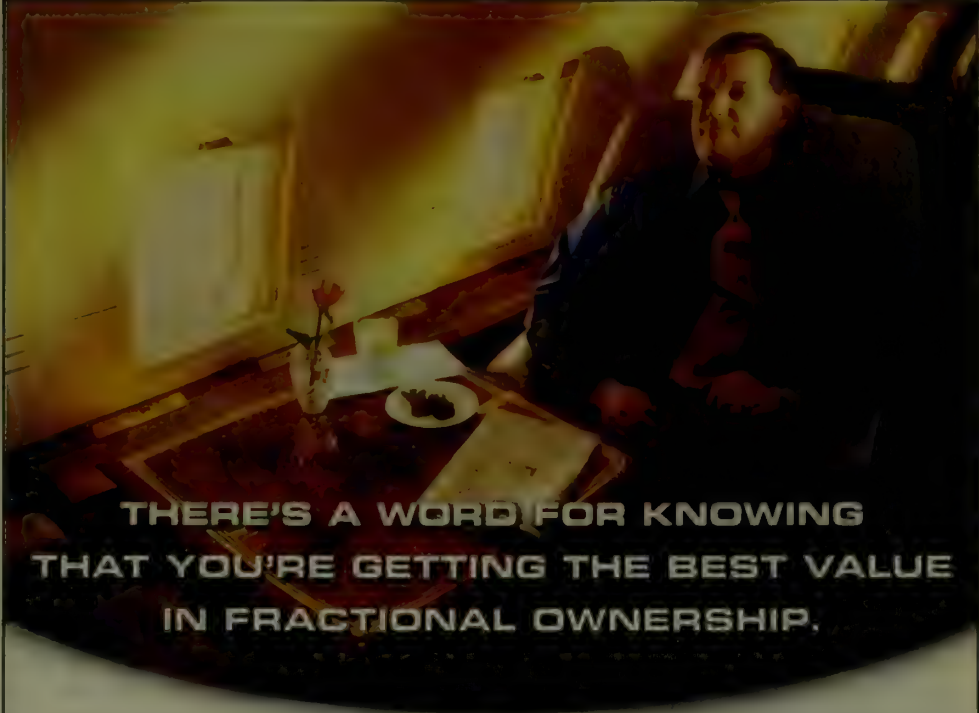
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DOT.BOMB

My Days and Nights at an Internet Goliath

By J. David Kuo

Little, Brown • 314pp • \$25.95

A HIGHFLIER'S LEGACY: LOW COMEDY

If you ever wondered what it was like to work in a high-flying dot-com company during the height of the Internet bubble, you're bound to love J. David Kuo's *dot.bomb: My Days and Nights at an Internet Goliath*. It's an insider's story of the rise and fall of an e-commerce company that should never have existed.

Kuo's tale of the Charlottesville (Va.)-based Value America Inc. reads like pure farce. He describes a passel of characters worthy of a Tom Wolfe novel: a nearly mystical entrepreneur who lacks a grip on reality; a CEO who believes that the company's success is solely dependent upon God; and our wide-eyed narrator, the get-rich-in-a-hurry flack brought in to hype the company and its stock. They work in what Kuo suggests is a chaotic, badly mismanaged company that can't seem to do anything right.

Yet the startup drew influential investors such as Paul Allen, co-founder of Microsoft Corp., and Frederick W. Smith, founder and CEO of FedEx Corp. Their involvement offered instant credibility to a failed but charismatic businessman, Craig Winn, who reinvented himself as an e-commerce visionary in 1996 with the founding of Value America. Positioned as a Wal-Mart on the Internet—or, in Winn's more flamboyant language, the “marketplace for the new millennium”—Value America was to be the future of retailing. (Winn's own self-published account will come out shortly.)

At first, the business model seemed smart and differentiated. When someone bought an IBM PC or a tube of Crest on the Value America Web site, the inventory-less company transmitted the order to the manufacturer, who supposedly shipped direct to the customer. Value America earned a retailer's profit but never had to touch the merchandise—at least, that was the idea.

Like everything with a .com suffix, investors eagerly flocked to Value America. On the day Winn took the company public in April, 1999, the \$23-a-share stock soared to a high of \$73.68, and Winn momentarily became a billionaire. Some 16 months later, Winn was gone, the stock was trading for pennies, and the company was in bankruptcy. Investors lost hundreds of millions of dollars in the debacle, and some very big names, among them Smith and Allen, lost a bit of credibility as well.

Even by dot-com standards, however, Value America comes across as something of a mirage. By Kuo's account, it was little more than a barely functioning mail-order-catalog outfit. About 70% of sales were made by telephone—when the telephone was actually answered. Toward the end of 1999, an internal study showed that hapless customers waited an average of nearly an hour to get through to Value America's customer-service desk. During one quarter in 1999, the company spent \$20 million on newspaper ads that only brought in slightly more than \$6 million in sales from new customers.

Winn, who got his start selling fly swatters and toaster ovens, regularly hyped the company and the stock, often stating as fact things that Kuo alleges were “materially untrue.” At one point, the company announced it had more than 400,000 customer-members. The real number was under 30,000, Kuo claims. Winn often claimed that Value America carried more than 1,000 brands, but underlings who inventoried them for the initial-public-offering prospectus found around 700. So the task called for improvising, according to Kuo. Six types of Near East couscous were counted as six separate brands,

and so on, until staff got the “more than 1,000 brands” number.

In Winn's world, reality was elusive. Kuo recounts that, after a sales meeting with Citibank officials that went nowhere, Winn reported to his newly hired chief executive. “Citibank was awed by me,” Winn said. “When we were leaving, they pulled me aside and said, ‘We are awed by your genius. We never met anyone like you.... We thought you were sent by God.’”

“Fantastic,” replied CEO Tom Kagan, knowing of Winn's tendency to exaggerate. “Really fantastic.”

“Fantastic?” groaned Winn. “I brought you news about what is undoubtedly the biggest deal in the history of e-commerce, and I get ‘fantastic?’”

Of course, there was no deal, merely an initial sales call by Winn attempt-



to open the door to a partnership that would never materialize. Four months later, Value America issued a press release on the company that Winn said would be worth “billions and billions”: Value America would be offering Citibank credit card holders special benefits—the kind of promotions everyone routinely tosses when monthly statements arrive.

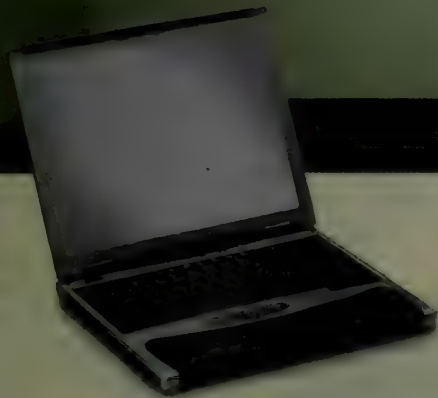
The author, a former political speechwriter, comes across as thoroughly gullible, just like the investors who bought into this dot-com nightmare. When hired in 1999 as vice president for communications, a job paying \$125,000 a year with stock options on 80,000 shares, Kuo concedes he thought he would help Winn build a retail version of Microsoft.” Kuo even believed that Winn had the right political stuff to become governor of Virginia—preliminary to a run at the White House.

Kuo's *dot.bomb* is a wildly entertaining romp through the worst of the dot-com era. At times, I laughed out loud at how many things became. Other times I wondered why so many of us, particularly investors, analysts, and the media, were so clueless.

BY JOHN A. BYRNE

Senior Writer Byrne described Value America's demise in a BusinessWeek cover story.

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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

THIS VIDEO RECORDER HAS SOME ENEMIES



Replay allows you to delete ads automatically or send shows to pals over the Internet

If you wanted to build a consumer-electronics product designed to drive the entertainment industry nuts, it would be hard to beat SONICblue's ReplayTV 4000 (www.replaytv.com). While basically a personal video recorder that gives you an easy way to record shows onto a big hard drive, Replay claims the ability to delete commercials automatically during playback and to send recorded programs to other Replay owners over the Internet. An assortment of outraged broadcasters and cable programmers has asked a federal court to block the sale of the product.

In truth, the commercial-skipping feature works erratically, and sending programs is hopelessly impractical, even with a broadband connection. But Replay is still an important product. It is in the vanguard of a new generation of consumer electronics equipped to connect both to home networks and to the Internet.

Recorders such as Replay and rivals from TiVo and Microsoft have been around for a couple of years. They give you a simple way to select programs from an on-screen guide for one-shot or repeated recording and to search for and select shows by title or genre. Replay marks a new high in recording capability, ranging from 40 gigabytes (40 hours at standard quality) for \$699 to 320 GB for \$1,999.

Previous versions used dial-up connections to download the program guide. Replay links to the Internet through a home network. That same connection can be used to transfer video to another Replay in your home or out onto the Net. You can also display photos stored on a Windows PC in your home as a slide show on a television set.

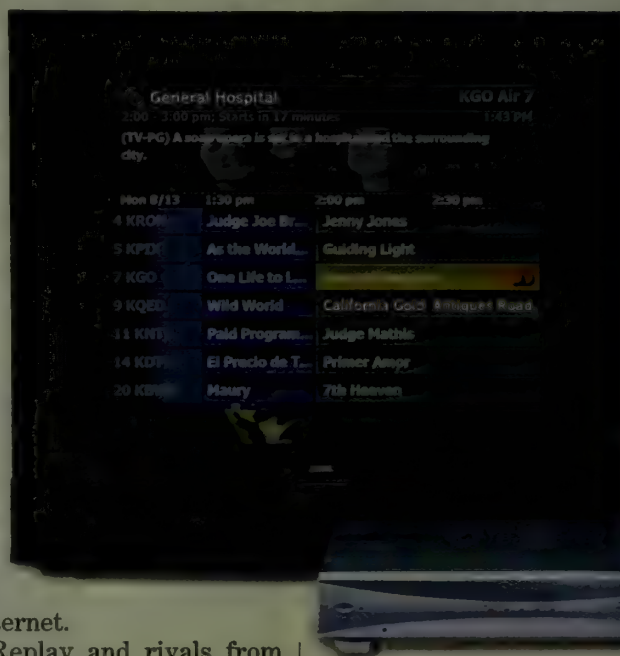
Make no mistake about it: This is bleeding-edge stuff aimed at technically astute buyers. It requires a broadband connection and a home network that includes a standard Ethernet connection handy to your television. (Given the trend in home-networking, a wireless option

would greatly enhance the appeal.) Setting box up to download program information is usually simpler than the old dial-up models configuring it to receive video over the Internet included the baffling instruction: "Open a port on your firewall and enter the port number here."

Broadcasters find the new Replay alarming. A suit pending in U.S. District Court in Los Angeles, content producers claim that the sharing of programs for personal use, not to mention sharing them, violates the Digital Millennium Copyright Act. Fortunately for the plaintiffs, sharing programs over the Internet isn't likely to be much of an issue in the real world. An hour of video fills a gigabyte of storage, and since broadband connections limit upload speeds to about 256 kilobits per second, sending a one-hour movie takes 18 hours. If you own two computers, you could send a movie to a second computer over a high-speed home network in less than five minutes. And in the not-too-distant future,

you'll probably be able to send a movie recorded on a Replay to a play or similar device to a network TV set anywhere in your home.

The industry is also alarmed at Replay's Commercial Advance feature, which SONICblue claims automatically deletes ads during playback. I found



THREATENING?

number of
broadcasters
have moved
to block
Replay

that it caught most commercials on prime-time programming, but, for some reason, was more erratic at other times. It also missed some ads during segments of five or more commercials. Still, a click of the 30-second advance button on the remote quickly got me past any commercials that remained.

The TV and movie industries, like record and music companies, view new technologies as a threat rather than an opportunity. Studios, which now find tape and DVD sales a very profitable business, went to the Supreme Court in the 1990s in a vain effort to block the sale of VCRs. The Recording Industry Assn. failed to stop Diamond Multimedia (since purchased by SONICblue) from selling Rio digital audio players.

Networked home-entertainment products are coming, whether the industry likes them or not, and they are going to get cheaper and easier to use. We can only hope the entertainment industry fails in its efforts to kill these new products before they have a chance to thrive.

BusinessWeek online

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BY LAURA D'ANDREA TYSON

FOR DEVELOPING COUNTRIES, HEALTH IS WEALTH



LIFE SAVINGS: Health-care investments of \$30 to \$40 per person could yield \$186 billion yearly in economic benefits to the poorer nations

Lord Chesterfield observed that good health is the first and greatest of all blessings and the first of all liberties. Millions of people in developing countries around the globe lack this blessing and basic freedom. What's more, their poor health both reflects their poverty and contributes to it. Economists have found a strong correlation between better health and faster economic growth—a correlation that holds up even after accounting for other factors that explain national differences in economic progress. Providing adequate health services to the world's poorest citizens could save millions of lives each year, reduce poverty, and promote development. Laudable as this goal is, can it be achieved? A carefully researched report from a World Health Organization commission chaired by Jeffrey Sachs of Harvard University—on which I served—concludes that the answer is yes.

A relatively small number of identifiable conditions—such as malaria, tuberculosis, childhood infectious diseases, maternal and perinatal nutritional deficiencies, and HIV/AIDS—are the main causes of illness and high mortality rates in developing countries. For each of these conditions, interventions that can dramatically improve health outcomes already exist. Most such interventions are not technically exacting and can be delivered by local health centers, working with state and private health-care providers and nongovernmental organizations.

Spending on health in the developing countries must increase significantly over the next decade, however. The WHO commission—known formally as the Commission on Macroeconomics & Health—estimates that the minimum cost of essential treatments, including those necessary to fight the AIDS pandemic, is between \$30 and \$40 per person per year in those countries.

This sounds like a trivial amount compared with average per-capita annual health spending of \$2,000 in high-income countries. But it is considerably more than the average per-capita health spending of \$13 per year in the poorest countries. Even if developing countries significantly increase the resources they devote to health and use such resources more efficiently, the WHO commission concludes that developed countries must contribute an additional \$27 billion per year by 2007. This increase is large compared with their current contribution of about \$6 billion per year, but it would amount to only about 0.1% of the gross domestic product of the developed countries, leaving ample resources for other developmental goals.

At the same time, the WHO commission knows that efficient delivery of development assistance for health will require new organizations such as the Global Fund to Fight AIDS, Tuberculosis, & Malaria. Commission members approve the establishment of this fund and endorse the U.N. recommendation that its resources be scaled up to \$8 billion a year by 2007. The commission also urges each developing country to establish a temporary commission to formulate a strategy for increasing domestic spending on health and extending essential health services to all citizens. The WHO has pledged to work with these national organizations to establish operational targets and a framework for the effective use of donor aid.

Drug companies, too, have a crucial role to play in the fight to improve the health of the poor. The WHO commission recommends that the global pharmaceutical industry formulate voluntary guidelines to ensure that essential medicines are made available to developing countries at the lowest viable commercial prices. Such guidelines should recognize the principle of differential pricing—meaning lower prices in low-income countries as the norm—and should provide for licensing of patented drugs to generic producers in developing countries. In addition, donor countries should negotiate with drug companies for the lowest prices on behalf of countries too small and poor to negotiate on their own. At the same time, developing and donor countries must work together to ensure that lower prices and generic licensing in poorer countries do not undermine market pricing and patent protection in high-income markets.

A sustained, cooperative effort to improve health in developing countries would yield benefits that far exceed its costs. The Commission on Macroeconomics & Health predicts that enactment of its recommendations could save about 8 million lives per year by 2010. The 8 million deaths prevented would translate into about 330 million disability-adjusted life years, a measure of more years of life and fewer years of disabilities.

Conservatively, each disability-adjusted life year saved would yield the economic benefit of one year's per-capita income in a developing country. The direct economic benefits of saving 330 million disability-adjusted life years would amount to \$186 billion each year. Because reduced disability translates into higher productivity, the total benefits would be larger. On economic and humanitarian grounds, the case is compelling for the world community to invest in the health of its poorest citizens.

Laura D'Andrea Tyson is dean of London Business School.



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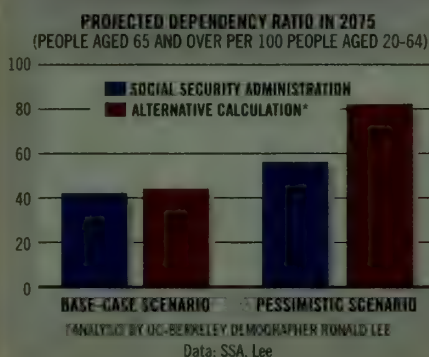
EDITED BY PETER COY

SOCIAL SECURITY: THE LONG VIEW

Making the case for pessimism

Each year, the actuaries of the Social Security Administration predict Social Security's financing needs for the following 75 years. In addition to their base-case scenario, they offer an optimistic projection and a pessimistic one, using different assumptions about fer-

BAD NEWS FOR SOCIAL SECURITY?



tility, longevity, economic growth, and other factors. The latest pessimistic forecast shows the Social Security Trust Funds running out of money in 2027, compared with a 2038 exhaustion date for the base case.

Is the Social Security Administration's pessimistic case pessimistic enough? No, says a new study by Ronald D. Lee and Ryan D. Edwards, both of whom are demographers and economists at the University of California at Berkeley. Unlike Social Security's actuaries, Lee and Edwards estimate the probability of every possible level for each relevant factor. Then they combine those to create a range of probabilities for the outcomes of interest.

They found that the chance of a really bad outcome is much higher than commonly expected. In the Social Security actuaries' pessimistic projection, the old-age dependency ratio—the ratio of elderly to working-age people in the population—reaches 56 per 100 in 2075. Lee and Edwards calculate there's almost a 25% chance the dependency ratio could go even higher than that. Indeed, they estimate there is a 2.5% chance that the dependency ratio could reach a crushing 82 per 100 or higher, if longevity rises and fertility falls over time. A higher ratio means the Trust Funds run out of money sooner, since there are

fewer workers supporting each retiree.

To be sure, Lee and Edwards also differ with the Social Security actuaries on the other end of the scale. They calculate that there's a chance the dependency ratio could be slightly lower than in the actuaries' optimistic projection. Nevertheless, the relatively high probability of a bad outcome suggests politicians may have to deal with Social Security reform sooner than they now realize.

DEBATING DECIMALIZATION

Do traders have a legitimate beef?

The New York Stock Exchange converted to quoting prices in increments of pennies instead of eighths or sixteenths of dollars on Jan. 29, 2001. The Nasdaq followed suit in April. Most analysts agree that small investors have benefited from decimalization. Because of a narrowing in the spread between the highest bids and the lowest offers, the little guys can pay less when they buy stocks and fetch more when they sell them. However, big money managers complain that the narrow spreads don't help them. They say the volume of shares that can be bought or sold at the best prices is too small for their needs—partly because some big traders have been driven away by the narrower spreads.

A new study by Plexus Group Inc., a Los Angeles firm that advises big money managers, suggests another reason for the managers' problems. The study confirms trading costs for large stock orders did go up on the NYSE after decimalization, from \$38 per \$10,000 of order value in the third quarter of 2000 to \$67 per \$10,000 in the second quarter of 2001 (table). Mark Edwards, a Plexus managing director who wrote the study, says that may be happening because money managers haven't yet gotten the hang of trading in a decimalized world.

Edwards says traders may be unwittingly raising their trading costs by trying too hard to disguise their orders.

HOW TRADING COSTS ROSE FOR BIG INVESTORS

COSTS OF EXECUTING
ORDERS OVER 250,000
SHARES ON NYSE
DOLLARS PER \$10,000
OF ORDER VALUE

	3RD QTR. 2000	2ND QTR. 2001
COST		
DELAYS IN EXECUTION	9	40
MARKET IMPACT OF TRADES	19	15
COMMISSIONS	10	12
TOTAL	38	67

Data: Plexus Group Inc.

Often, a big buy order will drive price up or a big sell order will drive price down. Worried that decimalization has made matters worse, traders have been dribbling out trades a little at a time. But slowing down the execution of trades can be costly for large institutional traders when they try to pick rising stocks and dump falling ones. Plexus Group calculates that for orders of 250,000 shares or more on the NYSE, the cost of execution delays rose from an average of \$9 per \$10,000 of order value in the third quarter of 2000 to \$41 per \$10,000 in the second quarter of 2001. The delay cost is the loss when a price moves against a trader while the trader is waiting to place a trade.

Moreover, Edwards argues that decimalization bling out trades didn't even work because other market participants realized what they were up to. Edwards: "If you're an elephant, you can't hide in the strawberries."

THE ECONOMY'S BONUS SETBACK

Variable-pay cuts may hurt spending

Since the last recession in 1992, the number of U.S. workers whose pay is tied to company performance has soared. With profits in the tank, economists think bonuses will be off—slamming personal income.

WorldatWork, a Scottsdale (Ariz.) association that tracks employee compensation, estimates that 77% of hourly employees receive profit-sharing payments or bonuses, up from 52% in 1997. The percentage of salaried workers receiving such pay has also reached 77%, up from 60% in 1997.

Morgan Stanley Dean Witter & economist Stephen S. Roach predict that with aftertax corporate profits estimated to fall 21% in the fourth quarter of 2001 from a year earlier, variable pay will plummet. As a result, he predicts consumption will fall 1% in the fourth quarter of 2002, vs. the 0.3% decline estimated by economists polled by the Chip Economic Indicators.

There are certainly forces supporting the consumer, including lower prices, lower interest rates, and the rebound of the stock market. But the loss of pay combined with the growing likelihood of layoffs will do more to undermine consumer spending, Roach argues. In the end of the day, it's income stability that matters," he says.

By Robert Berner in Chicago

JAMES C. COOPER & KATHLEEN MADIGAN

ON WITH THE NEW YEAR, BACK TO THE OLD RULES

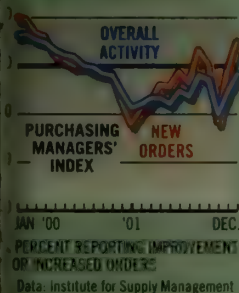
Time-tested fundamentals will drive growth, but slowly

U.S. ECONOMY

It looks like the beginning of a mood swing. Consumers are more optimistic. Their assessment about the future pared in December to the highest level since before September 11. And orders for capital goods—a good proxy for business sentiment—are up strongly two months in a row. While emotions are ephemeral, rising confidence is the most concrete evidence yet that the weakness in the economy is starting to ease up.

But even though the economy may be hitting bottom, there is nothing to suggest a return to the go-go days of the late 1990s when consumer spending grew at a healthy 5% or 6% annual rate and business executives felt compelled to buy the hottest new equipment. Instead, 2002 will see the return of the back-to-basics economy.

INDUSTRY ENDS 2001 ON A HIGH NOTE



Profits will dictate capital budgets. Last, despite the promise of just-in-time delivery systems, businesses have learned that the inventory cycle is not dead. Thankfully, though, inventory rebuilding will supply an important boost to growth this year.

The latest data on consumer confidence, durable goods orders, and industrial activity show that these additional forces were influencing the economy at the end of 2001 (charts). Signs of improvement, especially in manufacturing, suggest that the recession may soon be over. But because there is no strong catalyst for growth, the recovery will be far more sober than the typical upturn.

YET SO, consumers are upbeat about the future. The Conference Board's index of consumer confidence jumped to 93.7 in December from November's 84.9. Most all of the gain came from a surge in expectations about the economy six months from now. The expectations index jumped more than 14 points, to 55, its highest reading since August. Household as-

essment about the current situation edged up slightly.

The board said consumers' moods might have reached a plateau in part because of "a stabilizing employment scenario." The recent drop-off in new claims for unemployment benefits supports that notion. Progress in the war in Afghanistan, the fourth-quarter stock-market rally, and lower energy prices probably boosted sentiment as well.

Moreover, consumer actions underscore their feelings. Retailers were disappointed by Christmas sales, partly because of consumer wariness over the current economy and partly because deep price cuts robbed profits. But because the future looks brighter, consumers are willing to make the long-term commitment to a mortgage. In November, new home sales rose 6.4%, to an annual rate of 934,000, and sales of existing homes gained 0.6%, to a 5.2 million pace.

Unseasonably warm weather lifted the November data, but housing remains one of the U.S.'s most resilient sectors. In the eight months since the recession began, new-home sales have averaged 887,000 per month, down only 4% from their pace of the eight months before the economy's peak. In the 1990-91 recession, home-buying collapsed by 16.1%.

But because housing hasn't suffered much, it is unlikely to add significantly to real gross domestic product in 2002. That's a big reason why the recovery will be mild. For the first quarter, a return to more normal weather and the recent uptick in mortgage rates could knock the housing data for a loop. But the 2001 rise of new homeowners sets the stage for continued spending gains on home goods such as appliances and electronics.

DEMAND FOR HOMEGOODS

and other consumer items, however, will depend on how fast incomes grow in 2002, a trend that was evident in the fourth quarter. In October and November, real aftertax income was up 2.1% from a year ago and real consumer spending increased 2.9%. Back in 1999, when households used their stock-market gains or credit-card reserves to finance many of their purchases, real income rose 2.4%, but consumer spending soared by 5.6%.

This shift in behavior isn't hard to figure. Stock

A GLIMMER OF OPTIMISM IN DECEMBER



portfolios got hammered over the past two years, so investors aren't touching their holdings. And the recession has made many households think twice about taking on more debt. The new attitude means consumer spending will increase at a subdued rate in 2002, closer to 2% or 3% rather than 5%. It also suggests that the factory rebound, when it comes, won't be very strong.

THE BEST NEWS FOR MANUFACTURERS, therefore, is that excessive inventories will be much less of a drag on production in 2002. When demand soured in 2001, companies had to pare their stock levels by a record amount. This old-fashioned inventory cycle cut more than one percentage point from growth in real GDP last year. Business inventories likely shrank by the largest amount on record in the fourth quarter.

The December data from the Institute for Supply Management, formerly the National Association of Purchasing Management, suggest that inventories have finally shrunk so much that companies are increasing orders and production. The purchasing managers' index rose to 48.2% in December, from 44.5% in November. Inventories were drawn down for the 23rd month in a row. And the indexes covering new orders and production both rose above 50%, a sign that demand and output of manufactured goods increased last month for the first time since the autumn of 2000.

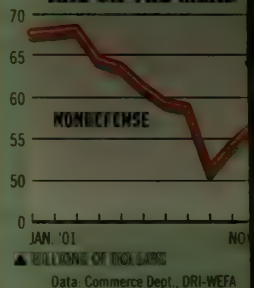
The extended drawdown of inventories has been led

by nondefense capital goods, including high-tech equipment. The ratio of tech inventories to sales has slipped for three consecutive months and is now at its lowest since April, 2001. But now, with inventories in better shape, companies feel more confident and are ordering supplies and equipment again. November durable goods orders fell 4.8% after a defense aircraft-related jump of 12.5% in October. But nonmilitary capital goods orders rose 4.8% in November on top of a 5.9% advance in October (chart). That was the strongest two-month gain since January, 2000, and it was led by increased booking for motor vehicles, computers, and electrical machinery.

The gain in capital-goods orders is a sign that executives think demand will rise enough over the next year to justify expanding capacity. To be sure, the factory sector isn't out of the woods yet. The latest data suggest only that, after 16 months of decline, manufacturing is finding a bottom.

Indeed, consumers and businesses seem to sense that the worst is over for the economy. But even as the business cycle takes a turn for the better, the old rules concerning spending and income and investment and production will apply ever more importantly in 2002.

CAPITAL GOODS ORDERS ARE ON THE MEND



Data: Commerce Dept., DRI-WEFA

BRITAIN

THE STIMULUS IS PAYING OFF

The British economy heads into 2002 in much the same way it traveled through 2001: on two separate tracks. Consumer spending and housing are strong, while manufacturing is in a recession.

The result is a mix of weakness and resilience that could make Britain the fastest-growing economy of the Group of Seven nations for the second year in a row. Economists expect growth of just over 2% in 2002, about the same as in 2001.

To be sure, the economy will not escape the global slowdown's impact on exports and manufacturing. Optimism among manufacturers dropped to a three-year low in December, and output ex-

pectations hit a 13-year low, reflecting excessive inventories.

The economy is slowing sharply in late 2001 and early 2002, but it should avoid outright recession.

Consumer spending has slowed from a gallop, but its underlying strength was evident in surging November retail sales. And while unemployment ticked up in October and November, it remains near a record low.

Britain's resilience mainly reflects stimulative policy from

both the Bank of England and government spending. The BOE cut interest rates by two percentage points in 2001, to a 37-year low of 4%. With core retail inflation in November at just 1.8%, which is

below the BOE's 2.5% target, economists are not ruling out another cut by February. The effects of those cuts on retail sales, house prices, and borrowing will spill over well into 2002.

Fiscal policy, which turned stimulative last spring, will offer further support in 2002. The government has recently announced new measures on pensions and health care, and various tax credits, in addition to already-announced increases in outlays for transportation, hospitals, and schools. The stimulus will total more than one percentage point of gross domestic product.

One implication of Britain's buoyancy: As manufacturers and consumers begin to head in the same direction later in 2002, the BOE may well be the first central bank to tighten monetary policy.

SALES GROWTH HITS A 13-YEAR HIGH



DATA: DRI-WEFA

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IT SURE IS GETTING HOSTILE

Unsolicited offers are on the rise in a market ripe for consolidation

What's the matter with a little hostility? Nothing at all, if you ask Dimitri J. Boylan, chief executive of online employment service HotJobs.com. Six months after he set plans to merge with TMP Worldwide Inc., parent of rival Monster.com, media giant Yahoo! Inc. on Dec. 12 barged in with an unsolicited offer to buy HotJobs for \$436 million in cash and stock. With \$81 million more on the table than TMP was willing to pay by late December and stronger growth prospects, it took less than three weeks for Boylan to say yes to Yahoo's hostile bid. "[I was] surprised to get the phone call, but not surprised by the strategy," says Boylan.

HotJobs isn't the only company on the receiving end of such calls these days. As companies ranging from cable-television provider AT&T Broadband to cruise liner P&O Princess Cruises have discovered, hostile takeovers are back with a vengeance. The combination of a weakened economy, downtrodden stock prices, and new accounting practices sent hostile bids soaring in 2001, with more on the way. "We've clearly seen an uptick," says David M. Baum, co-

head of mergers and acquisitions in North America at Goldman, Sachs & Co. "And we're likely to see unsolicited activity accelerate."

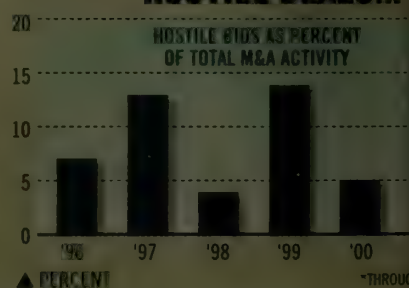
Indeed, from just \$40 billion in 2000, the value of announced hostile deals more than doubled last year, to \$94 billion. That's well above the \$81 billion peak hit in the 1988 heyday of the hostile deal, and close to the record set in 1999 as the stock market topped out. That year, the combination of lofty share prices and one outsized deal by Pfizer Inc.—which paid \$90 billion for Warner-Lambert Co.—led to a record \$103 billion in hostile deals.

Not surprisingly, all that predatory dealmaking is also spurring more companies to take defensive maneuvers: The adoption of shareholder-rights plans known as poison pills is also back up. And that's not the only way the hostile takeover game has changed since it first burst on the scene in the 1980s. Then, corporate raiders like Carl C. Icahn and Henry R. Kravis scoured the landscape for companies with un-

A WEAK MARKET...



...IS SPURRING HOSTILE DEALS...



dervalued assets to restructure and sell. Now, the predators are more likely to be blue-chip industry leaders like Comcast, which is buying AT&T Broadband, and Weyerhaeuser, which is trying to combine with Willamette Industries (page 30).

Why the rise in hostile deals now? The recession is the driving force behind the trend. The weak economy, scarce profits, and rampant overcapacity in many sectors have pushed industry leaders to try to strengthen their positions by forcing consolidation (page 32). And for those with the financial muscle, there's little question plenty of assets and businesses can now be gotten on the cheap. With the Standard & Poor's 500-stock index down 13% in 2001 alone, shares of weaker companies are at bargain-basement prices.

For mainstream companies, the repercussions of failing at a hostile bid also have lessened. Because failing to pull off a deal used to be considered a major embarrassment on Wall Street, acquirers felt compelled to engage in bidding wars no matter what the cost—so they thought long and hard before moving ahead. Now, even if a takeover fails, investors often reward a predator. "We're seeing more companies make proposals on transactions that are prepared to walk away if the deal does not create value for their shareholders," says Donald Meltzer, head of global M&A at Credit Suisse First Boston.

Regulatory changes are also giving companies greater incentive to fire away. Bankers expect the antitrust environment under President Bush's Administration to be easier, so CEOs are less worried about making aggressive offers to gobble up smaller rivals. "Coming out of the recession, people are less concerned about these issues than getting things rolling again," says James R. Elliott III, head of North American M&A at J.P. Morgan Chase & Co.

Even accounting rules are helping to spur hostile deals. In the past, predators shied away from all deals—hostile and friendly alike—where their own earnings would have been diluted because of the need to amortize goodwill. That's the difference between the amount an acquirer pays for a company

and what its assets are on its own balance sheet. But in July, the Financial Accounting Standards Board decided to end the practice of amortizing goodwill. "One of the great defenses against hostile offers has been eliminated," says tax and accounting analyst Robert Wilens at Lehman Brothers Inc. The change has been particularly important in industries built on human capital, such as biotech, technology, and financial services, because the difference between companies' asset values and their stock valuations have typically been large.

That's one key reason hostile deals

are soaring in the tech sector. Indeed, 62% of the hostile bids in 2001 involved failing dot-coms, cash-strapped telecom players, and other tech companies, up from 24% of hostile deals just a year earlier. But there's another, more prosaic explanation as well: In the past, acquirers generally avoided hostile deals in tech, since many feared a target's

main assets—its engineers, developers, and other valuable employees—would flee. But with the economy in a recession and unemployment rising, unhappy employees have fewer places to move to. "[Tech] takeover targets can't take as much comfort as they have in the past," says Doug W. McNitt, general counsel at webMethods Inc., a Fairfax (Va.) company that specializes in linking computer systems.

That isn't to say companies have been shorn of all defenses. The rise in hostile activity is also spurring another round of poison pills designed to make life tougher for potential acquirers. In 2001, 283 companies adopted poison pills, 74 more than in 2000. And given the plunge in stock valuations they've suffered, it's hardly surprising that tech companies and dot-coms such as BEA Systems Inc. and E*Trade Group Inc. accounted for 31% of the poison pills enacted in 2001, up from 24% last year. "Many CEOs are actively reviewing their companies' defensive profiles," says Michael J. Boublik, head of East Coast technology M&A at Morgan Stanley Dean Witter & Co.

Some managements are going so far as to hire investment bankers just in case they get hit with a hostile bid. "Over the last 12 months, we have more than doubled our defense retain-

NO GOODWILL

Accounting-rule changes help to spur deals: "One of the great defenses... has been eliminated"

AND POISON PILLS HEAD BACK UP

ANTI-TAKEOVER
MEASURES



Source: IB Financial Markets, Goldman Sachs, Thomson Financial

er business," says CSFB's Meltzer.

For now, however, the return of poison pills has left investors relatively sanguine. The reason? Unlike in the '80s, when such measures were often used to protect entrenched management, today's pills are more geared to prompting unwanted bidders to increase their offers. Bankers now point to a wealth of evidence that they ulti-

mately pay off for investors. J.P. Morgan Securities' research shows that since 1997, U.S. companies worth more than \$1 billion with pills in place received a median premium of 35.9%, vs. 31.9% for companies without. "Your typical investor can point to more situations where boards used pills to get higher bids than to boards that used pills to forestall [deals] altogether," says

Patrick McGurn, vice-president and rector of corporate programs at Institutional Shareholder Services. Considering many of the other earmarks of these hardscrabble times, it's at least a trend that investors can bank on.

By Emily Thornton in New York with Faith Keenan in Boston, Christopher Palmeri in Los Angeles, and da Himmelstein in San Mateo, Calif.

COMMENTARY

By Stanley Holmes

IT'S TIME FOR WILLAMETTE TO GIVE IN TO WEYERHAEUSER

It has been emotional, nasty, and seemingly endless. Indeed, the fierce hostile-takeover battle that began way back in November, 2000, between two Northwest timber rivals, Weyerhaeuser Co. and Willamette Industries Inc., could drag on for several more months. Despite repeated Willamette board meetings to consider Weyerhaeuser's sweetened \$55-a-share bid, Willamette shows few signs of yielding.

Too bad, because a Weyerhaeuser-Willamette combo makes good strategic sense. The industry is in the midst of a broad consolidation to reduce excess capacity, of which Willamette has plenty. A successful Weyerhaeuser bid would also give Willamette investors a tidy premium of 40% over its \$33 share price prior to Weyerhaeuser's original bid. Further, it would preclude any more ill-considered moves on the part of Willamette's management.

Investors clearly want a deal. In October, a majority of shareholders backed a tender offer at \$50. Yet in his damn-the-torpedoes attempt to outrun the Weyerhaeuser offer, Willamette Chairman William Swindells has been maneuvering to acquire the building products division of Georgia-Pacific Corp., another forest products company with serious problems. The \$3.5 billion offer announced in December, Swindells has argued, is the only way to make

Weyerhaeuser and its CEO, Steven R. Rogel, go away.

But acquiring the GP unit would create more difficulties than it would solve. A GP deal would give

Willamette a gypsum wall-board business that carries big potential asbestos liabilities and a costly distribution system vastly differ-



SWINDELLS: Rogel's intense rival



ent from Willamette's own. That would be a sorry result for a Willamette management team that up until now has had one of the best-run operations in the industry.

DEAL TIME?

Investors want Willamette to accept Weyerhaeuser's \$55 dollar bid



The problem with this fight is that it has been far too personal from the start. The two rival chieftains go way back: Weyerhaeuser's Rogel once held the same post at Willamette, where, as a 20-year veteran, he was Swindells' protégé. Not long into the takeover battle, incensed Willamette execs taped a

picture of Rogel to a voodoo doll, placed it on a desk in the hallway that ran through the Portland (Ore.) executive suites, and jabbed pins into their former boss. Says Willamette CEO Duane C. McDougall: "It was a pretty good indication of how people were feeling."

Swindells has vowed he will never sell to Rogel. The Willamette board has used every means to try to scotch the deal, including plumping up golden parachutes, withholding shareholder mailing lists from Weyerhaeuser, and threatening to trigger a hugely dilutive poison pill.

Yet all that pales compared with Willamette's plans to buy GP. With GP's myriad problems, many investors see the potential deal as a "scorched-earth" tactic to thwart Weyerhaeuser. Even members of the founding family, who have supported Willamette until now, are against it. "Those types of companies at GP are not the core business of Willamette," says Richard M. Clark, a son of one of the company's founders, who controls about 3% of its shares. He is now willing to sell for \$55 a share.

One way or the other, a decision will have to come by June, when a proxy vote over board membership is set. Last year, Weyerhaeuser won three seats on a nine-member board after waging a heated proxy battle. Unless Swindells goes ahead with the GP bid—in which case Weyerhaeuser will withdraw its offer—it looks like Weyerhaeuser will win three more seats and board control in June. Ultimately, Swindells may win this battle—but at a heavy cost to the company and its shareholders. It's time he gave up the fight.

Holmes covers the forest products industry from Seattle.

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STRATEGIES

MAKING HAY WHILE IT RAINS

Companies with healthy balance sheets are buying rivals, cutting prices, and boosting marketing

While other hotel executives have been trekking to Washington seeking relief for their hard-hit sector, Hilton Hotels Chief Executive Stephen F. Bollenbach has taken a different tack. He has been spending liberally to renovate such top-of-the-line properties as the San Francisco Hilton & Towers. And instead of remodeling just a planned five floors at a time, he's overhauling 10 at a bound—taking advantage of slack occupancies at the 1,900-room site to replace everything from furniture to draperies.

Throw in renovations at Hilton units in New Orleans, Cleveland, and Salt Lake City, and the tab will come to \$40 million. That doesn't count the \$25 million Bollenbach plans to spend to build a 319-room tower in Portland, Ore., a new ballroom in La Jolla, Calif., and a new restaurant in Alexandria, Va. Says Bollenbach: "Now is the time to take market share from our competitors."

While plenty of managers seem shackled by the uncertainty brought on by recession, coupled with the new dangers and costs of terrorism, opportunists such as Bollenbach see this as a terrific opening to advance their strategies.

Their goal: to out hustle, outmaneuver, or just plain outmuscle weaker competitors to be even further ahead when the recovery comes. "If you have a strong financial structure, gambling on picking up market share in a downturn can often be a great strategy," says David A. Wyss, chief economist at Standard & Poor's.

To be sure, more is required than an iron stomach and a roll-the-dice disposition. Investing in a downturn takes a healthy balance sheet, a strong core brand, and, often, the advantages that come with being the lowest-cost producer in a market. Those blessed with such strengths are slashing prices, pumping up marketing budgets, pouring capital into new equipment, and buying weakened rivals in hopes of coming out of the slowdown in much better shape.

Put another way, it's a great time for the strong to press their rivals to the wall. Companies that are able to exploit the downturn went into it with their financial houses in order—and many have continued to strengthen their balance sheets. That sturdiness allows them to grab more market share without having to worry as much as their more fragile rivals about the short-term financial consequences. Indeed, such moves are often aimed at putting

ever more financial pressure on the faltering. "If you haven't got a strong balance sheet, you just can't take some

of the risks—whether that's the operating risk of running a loss for a while or a business risk of making acquisitions or making a major expansion," says Robert G. Atkins, a vice-president at Mercer Management Consulting Inc.

But financial health is just a start. The question is, how best to use it? For many, the answer is simple: acquisition. With share prices at most companies now trading at just a fraction of what they were 18 months ago, bargain hunters are on the prowl. No. 1 electronics retailer Best Buy Co., seeing limited growth potential in its superstore concept, is snapping up suddenly more affordable retailers in other formats. Recent deals, including the \$3 million purchase of 91-unit Future Shop Ltd. in Canada, quadrupled its store count. "In relationship to what other houses had sold for in the neighborhood, we got to buy this one at a little cheaper price," says Chief Financial Officer Darren R. Jackson.

Even the staggering media business, suffering its steepest downturn in decades, has its share of opportunists. Tribune Co., though suffering badly from the advertising drop, wants to ac-

BETTING ON GROWTH

As the going gets tough, some companies are seizing on the downturn to strengthen their position. Among the strategies:

PRICE CUTS

The lowest production costs in the PC industry have allowed Dell Computer to slash prices and grab share from rivals Gateway, Compaq, and Hewlett-Packard, even as it puts enormous pressure on their margins.

CAPITAL EXPANSION

A weak retail outlook? Not at Wal-Mart, which will open 415 stores over the next year in its most aggressive capital spending plan ever. Count on it gaining share over such weakened competitors as Kmart.

AGGRESSIVE MARKETING

Ad spending may be tanking most everywhere, but Sara Lee and Wendy's plan to boost ad outlays by 25% and 30% respectively. With media rates declining, they'll get an even bigger bang for their buck.

ACQUISITIONS

With asking prices falling, superstore chain Best Buy spotted a chance to plug a gap in its strategy by purchasing Canada's Future Shop and other retailers with electronics stores in smaller formats.

its portfolio of TV stations. At the same time, it's investing \$100 million in a joint venture with Knight Ridder Inc. to acquire job bulletin board Headwater.net, bringing into the fold what once was seen as a dire threat to newspapers' classified-advertising business. As some portfolio managers say, you would buy at the time of maximum pessimism," says Tribune President Dennis J. FitzSimons.

If acquisitions are fine for some, for many businesses, there's a more immediate way to bolster their position at the expense of rivals: slash prices. And one thing is clear after a Christmas season in which retailers from Gap to Nordstrom discounted both early and often, it's that the strong are turning increasingly to price wars to try to grab market share. Here, the key isn't simply having a strong balance sheet—to come out ahead, it also helps to have the low-price costs in an industry. That way, any price war is guaranteed to wreak more havoc on rivals' profits and market position than on the company leading the price spiral down.

That's the logic driving Dell Computer Corp., which slashed computer prices 16% in 2001. Sticker prices on some machines have dropped by as much as 7%. The payoff: At 14.5%, Dell's market share is up 1.1 percentage points since where it was in the three months ending in September, says market researcher International Data Corp. The price-cutting has put Gateway on the sidelines, cut into Hewlett-Packard's piece of the market, and helped Dell share the No. 1 spot in global PC sales from Compaq. What's more, Dell has also won 36 large corporate accounts, worth \$270 million, so far this year. "We're in full account-acquisition mode," says CEO Michael S. Dell.

"The whole market is down. We continue to be up."

How so? Dell's streamlined procurement, manufacturing, and distribution systems have blessed it with a low breakeven point that lets it cut prices while staying solvent. True, Dell has had to lop off thousands of jobs and recently logged its first losing quarter in eight years. But in the quarter that ended Nov. 2, Dell rang up profits of \$429 million on revenues of \$7.5 billion. And when tech buying bounces back, Dell expects customers it has lured with deals on PCs and low-end servers to ante up for more expensive gear.

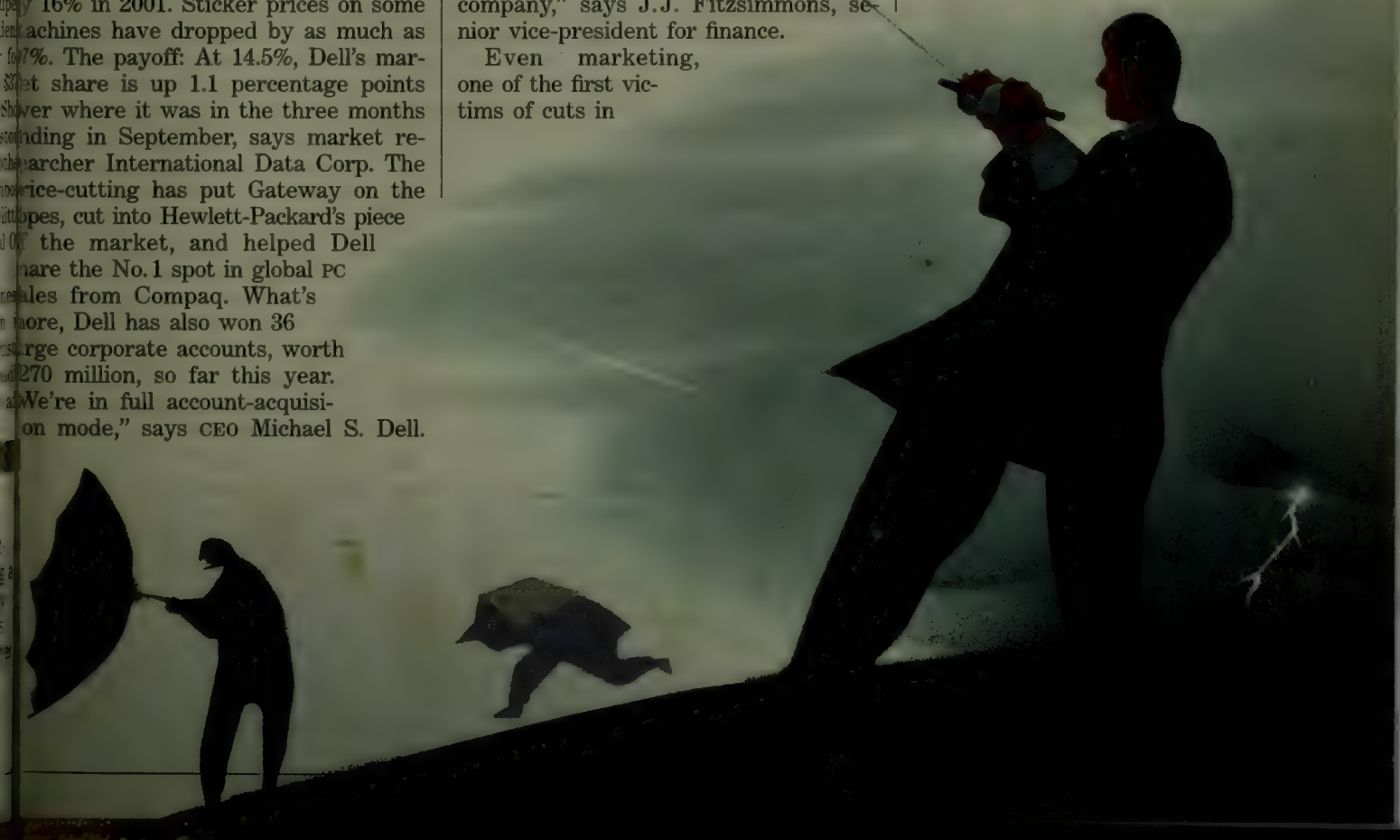
Of course, cutting only gets you so far. Even as belts are being tightened, some companies are continuing to spend where it matters. Far from hunkering down, Wal-Mart Stores Inc. is undertaking its biggest expansion ever. Betting that it can take business from Kmart, Sears, and a fragmented supermarket industry, the discounter will spend about \$10 billion this year on capital projects, up \$1 billion from 2001, to add 46 million square feet of retail space. "We refer to ourselves as maybe the world's only \$200 billion growth company," says J.J. Fitzsimmons, senior vice-president for finance.

Even marketing, one of the first victims of cuts in

a recession, is getting a sharp boost at companies such as Sara Lee and Wendy's International. Sara Lee, with a diverse product line spanning cheesecake, panty hose, and shoe polish, is juicing advertising by 25%, to \$434 million, in 2002. No mean increase even in flush times, it's a particularly strong boost in brand exposure considering how much the price of TV air time is falling. CEO C. Steven McMillan has even told his managers that they won't get bonuses if they try to meet financial targets by cutting marketing budgets.

Given the degree of economic and political uncertainty that confounds planning, McMillan is countering what is a natural reaction. Indeed, plenty of companies are sounding the retreat. Still, the players who wind up in the best position may be those who take the risky-seeming opposite course. And placing those bets will always be a game only the strong can play well.

By Julie Forster in Chicago, with Andrew Park in Dallas, Christopher Palmeri in Los Angeles, and bureau reports



COMMENTARY

By Richard S. Dunham

WHERE HAVE ALL THE CENTRISTS GONE?

It's a lousy way to run a country."

That divide could foreshadow a nasty, unproductive year in Washington as public attention shifts from the war on terrorism to recession and recovery. Among the likely hot spots: business tax cuts, regulatory relief, Social Security privatization, and a prescription-drug benefit for seniors. In each case, Democrats will accuse Republicans of trying to pay back their corporate patrons, while the GOP will accuse the Dems of being in the pocket of unions, trial lawyers, and radical environmentalists. "To compromise means to give away what their biggest supporters

LIKELY VICTIMS OF GRIDLOCK

Issues to watch:

TAX CUTS Republicans will demand a new round of cuts for business and accelerated rate reductions for individuals

SOCIAL SECURITY PRIVATIZATION Democrats will accuse the GOP of promoting a risky new scheme that puts retirees' money in jeopardy in the stock market

REGULATORY RELIEF The White House is preparing a broad offensive against government regulations it sees as restraining business growth and profits

MEDICARE Democrats will demand a new prescription-drug entitlement for seniors

Data: BusinessWeek

want," says Charles Cook, editor of the nonpartisan *Cook Political Report*. "It's always easier to say, 'I went down fighting for you.'"

This doesn't mean a complete lack of progress. Both parties need to chalk up some accomplishments in an election year. Election reform is headed for passage [page 43], and trade liberalization legislation is likely to win final approval soon. Compromise also is likely on two stalled proposals—a Patients' Bill of Rights and energy legislation—if President Bush is willing to use some of his accumulated political capital.

Still, with Democrats holding a

one-vote edge in the Senate and Republicans protecting a five-seat cushion in the House, hyperpartisanship could be the order of the day. And that will only accelerate public discontent. Already, "the biggest party in the country is really 'No Party,'" concedes Democratic pollster Mark Penn. Swing voters overwhelmingly want moderate solutions to national

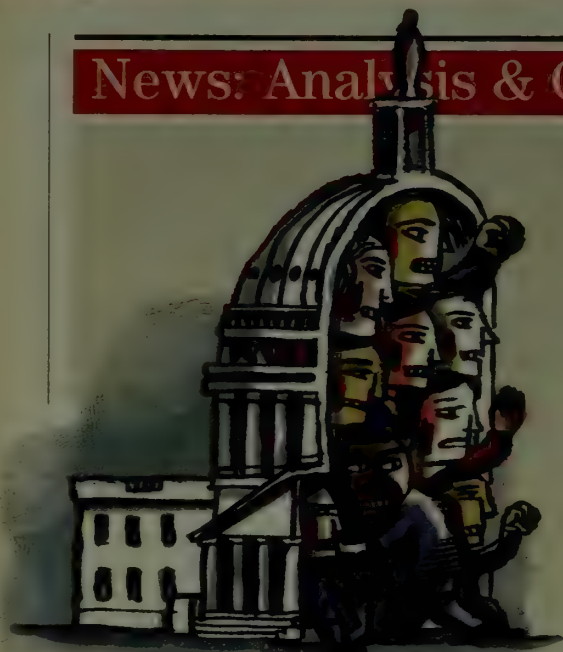
problems, and by three-to-one would be more inclined to support centrist candidates, according to a recent Penn poll.

So why the disconnect between independent-minded Americans and Capitol Hill? For one thing, the political extremes are disproportionately represented. The reason: Nearly 90% of House districts are heavily weighted toward one party or the other, and primary elections are dominated by true believers. That leaves about 40 moderate Democrats and a

dozen GOP centrists in competitive districts holding the balance of power. But most of the centrists have been intimidated into submission by their parties' ideological hierarchies.

Unless Bush moves the domestic agenda to the center, moderates will keep fading. Although lawmakers such as Senators Olympia J. Snowe (R-Me.) and Joe Lieberman (D-Conn.) continue to search for consensus solutions to divisive issues, there are too few heavyweights to counteract the centrifugal force that's pulling Washington toward the extremes.

With Lorraine Woellert and Alexandra Starr in Washington



Watching the debate over now-stalled economic stimulus legislation was a little like watching human evolution in reverse: Both parties seemed to regress back to their Neanderthal roots.

Republicans, who began 2001 determined to retool their message into a more user-friendly "compassionate conservatism," became the Party of Big Business again. They made their last stand of the year on alternative-minimum-tax relief for the likes of General Electric and IBM.

Democrats came off equally poorly as the party of liberal interest groups and government spending. No new tax cuts, not even a teeny one, for anybody who isn't certifiably middle-class, they cried. After a decade of Clintonian efforts to create a "New Democrat" party attractive to entrepreneurs and fiscally moderate independents, leaders such as Senate Majority Leader Tom Daschle (D-S.D.) and House Minority Leader Dick Gephardt (D-Mo.) have returned to their labor-populist, anti-corporate roots.

Despite the national pulling-together after September 11, the two parties are more polarized on spending and taxes than at any time since the Reagan years. "There is nothing that divides our parties more, philosophically, than economic policy," says Daschle. Frets Representative Amos Houghton (R-N.Y.), a leader of the moderate Main Street Republicans: "We're reverting back to our aboriginal state."



NO, GEORGE:
Jeb Bush is on the side of the tourism biz

became the target of an intense yet quiet Administration campaign to open up the offshore fields. With the heat on from his brother, Jeb has had to publicly agree to accept drilling outside a 100-mile perimeter of the Florida coast. A total of 17 oil companies bid \$340 million on a small number of the 6 million tracts.

Now drilling foes plan to challenge the oil companies over every one of the dozens of state and federal permits needed to begin work. This is no idle threat. The companies can't start without scores of permits from the Environmental Protection Agency and other federal agencies. Each permit must go through a series of hearings where opponents can voice objections. The loss of any permit can stop the drilling. "We always get an overwhelming show of force against the industry," says Mark Ferrulo, director of the Florida Public Interest Research Group, which opposes exploration.

Lawsuits are also likely. If permits are granted, environmentalists plan to sue to stop exploration under the Endangered Species Act, arguing that sperm whales in the Gulf would be threatened. Others may also sue the Commerce Dept. in federal court if it grants ChevronTexaco the drilling rights it won back in 1988.

Florida's officials are making themselves heard in Washington, too. Governor Bush has written to Commerce Secretary Donald L. Evans asking the federal government to deny ChevronTexaco drilling rights. Meanwhile, Senator Bill Nelson (D-Fla.) is lobbying Congress to let Florida repurchase any of the recently leased rights and retire them. "We sell Florida on its clean and pristine beaches," says Lenne

Nicklaus-Ball, vice-president of the Nicklaus Group, which owns the plush Sirata Beach Resort in Tampa. "A spill would devastate Florida's tourism industry." True enough. But that's a risk that the White House appears willing to take.

By Charles Haddad in Atlanta, with Laura Cohn in Washington

ENERGY

FLORIDA DRAWS A LINE IN THE SAND

The feds want offshore drilling—but opposition is fierce

For more than a decade, to be a Floridian has meant opposing offshore drilling. Nearly everyone in the state, from environmentalists and the tourism industry to successive inhabitants of the governor's office, fought attempts to drill in the nearby oil and gas fields under the Gulf of Mexico. Now, however, the oil industry, backed by a friendly White House, has finally won a round. On Dec. 5, the Interior Dept. auctioned off the rights to drill on 5 million acres about 100 miles off Florida's west coast.

That's not all. ChevronTexaco Corp. is on the verge of winning federal approval to drill 25 miles off the pristine beaches near Pensacola. "We've been peering over the fence for the past 13 years, and at last we're being allowed inside," says Robert J. Allison Jr., chairman of Anadarko Petroleum Corp., which won the biggest share of the recently auctioned rights.

But don't count on drilling beginning any time soon. Granting leasing rights is only the most recent salvo in this decades-old battle, which is largely being fought between oil interests and Florida's huge tourism industry, who have received a helping hand from environmentalists. It has already pitted two prominent political brothers against each other. President Bush wants more domestic exploration, while his brother Jeb, Florida's governor, opposes it in

his state. And even oil executives concede that opponents—who are gearing up to fight the oil companies through lawsuits and challenges to the permitting process—could halt drilling for up to five years, if not kill it altogether.

Until now, there has never been a commercial well drilled off the state's coast. But hundreds of rigs dot the horizons of other Gulf states' shorelines. The difference: Florida's \$50 billion tourism industry. "Any perceived threat to the Panhandle's clear waters and world-renowned beaches injures our tourist industry, the backbone of Florida's economy," says Governor Bush.

Some in Washington are less convinced by that argument. Governor Bush

OIL WARS

Opponents of drilling for oil off Florida's Gulf Coast will fight to limit exploration by:



► Tying up drilling permits in administrative hearings on oil company safety practices and environmental records

► Suing the 17 oil companies involved, including Anadarko Petroleum and Shell Oil, under the Endangered Species Act

► Lobbying Congress for legislation that would permit Florida to buy back ChevronTexaco's leases off the Panhandle

AUTOS

DAIMLER AND CHRYSLER HAVE A BABY

The Crossfire is the first sign they're meshing

Barely a year ago, Chrysler designers wowed the folks at the Detroit auto show with a sensuous new concept car called the Crossfire. Although the reception was gratifying, many at Chrysler thought there was little chance the two-seat roadster would ever be built. After years of record sales and profits, Chrysler was suddenly in a tailspin. Six weeks earlier, with costs out of control, parent DaimlerChrysler had sent two of its best German managers to Detroit to untangle the mess. Their assignment: Slash spending.

But to the surprise of many, a struggling Chrysler announced on Jan. 3 that it will expand its lineup to include the Crossfire, beginning in 2003. The decision comes even as Chrysler is chopping some \$10 billion, or 25%, out of its five-year product plan. And the market for two-seat coupes is small, so analysts don't expect Chrysler to sell more than 20,000 units or so. Even so, for symbolic and financial reasons, the Crossfire may be the most important vehicle Chrysler has introduced in years.

The Crossfire is the first concrete evidence that Chrysler and Daimler Benz, which merged in 1998, are starting to mesh. It has a sleek Chrysler look, while many of the components under the hood are borrowed from Mercedes. That makes the Crossfire "the first true child of the merger," says Chrysler President Wolfgang Bernhard.

The 41-year old German, who arrived



MIDWIFE: Bernhard cut costs by taking components from Mercedes

at Chrysler's Auburn Hills (Mich.) headquarters in November, 2000, along with new CEO Dieter Zetsche, gets credit for turning the Crossfire into reality in record time—18 months. To do so, he tapped engineering contacts back home to pry loose Mercedes components Chrysler could also use. He also pushed American engineers to squeeze development costs on other vehicles by as much as 30% to come up with the money for Crossfire.

DaimlerChrysler promises even more component-sharing in the future. Chrysler's next-generation family sedans will use a version of Mercedes' rear-wheel-drive transmission, as will its redesigned Dakota pickup and Durango sport utility vehicle. The sharing will go even further with Mitsubishi Motors Corp., which is also controlled by DaimlerChrysler. The Japanese car-

maker is working closely with Chrysler engineers to develop joint platforms for future small and midsize cars. By adding parts that have already been engineered elsewhere, DaimlerChrysler can save hundreds of millions in development costs. Cloning Mercedes' gear for its family sedans may save Chrysler as much as \$100 million, execs say.

That would be a huge step toward realizing the global efficiency at the heart of Daimler's strategy. After a loss at Chrysler approaching \$2.5 billion in 2001, DaimlerChrysler needs to start making good on long-promised synergies. Just breaking even at Chrysler in 2002 would be a relief after three years of post-merger tussling over management issues and relentless cost-cutting.

Getting the two sides to work together, however, was no mean trick. DaimlerChrysler jealously guards the Mercedes brand image; the last thing it wants is for consumers to perceive the luxury marque as just a more expensive Chrysler. "The engineers who have loved to take a bit more [of Mercedes for the Crossfire]. But they did come up with those proposals because they knew we'd say no," says DaimlerChrysler CEO Jürgen E. Schrempp.

But with DaimlerChrysler under increasing pressure from investors to live on the merger's economies, including parts-sharing, they had to give so much ground. The result is a stylish Chrysler whose guts are all Mercedes, from its most popular engine in the U.S., the 3.2-liter V-6, to its transmission, axle, seat frames, and radio controls. In fact, nearly 40% of the Crossfire's content comes from Mercedes. The sticker price Chrysler isn't saying, but analysts predict \$35,000. If it helps get the merger in gear, it may well be priceless.

By Joann Muller in Auburn Hills, Mich., with Christine Tierney in Frankfurt

FAMILY TIES

Chrysler's Crossfire is the first of several new models in the works that will blend Chrysler styling with Mercedes engineering. Among the more promising offspring:

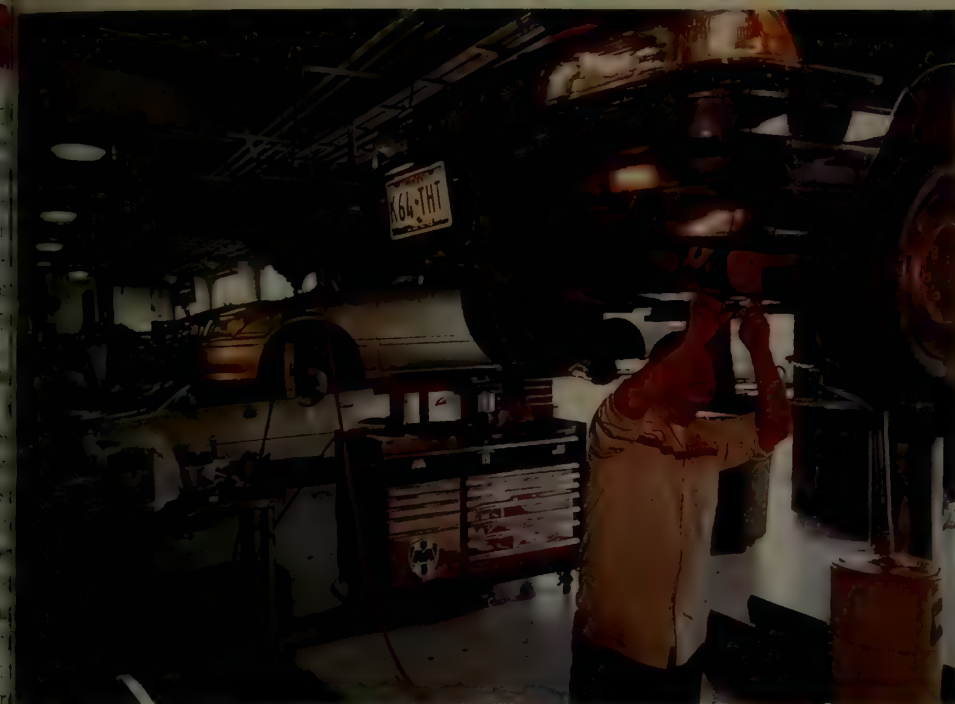
2003 PACIFICA The sports wagon will borrow rear suspension and axles from Mercedes.

2004 DODGE INTREPID, CHRYSLER CONCORDE These next-generation family sedans will use Mercedes rear-wheel drive transmission and electronics.

2005 DAKOTA The pickup will incorporate a five-speed automatic Mercedes transmission.



THE CROSSFIRE



THE BAY'S THE THING

A Toyota mechanic does repairs in Houston. High margins on service have dealers installing more bays

margins. Houston-based Group 1, for example, makes 12% gross margins on used-car sales, vs. 8% on new cars. Still, those fat margins can't hide the fact that used-auto sales are unlikely to increase as much as new-car sales will fall. During the 1990-92 recession, for example, used-car sales rose by 400,000, as new-auto sales fell by 1 million.

This time around, the gap could be even greater, because the market for pre-owned wheels is coming under pressure, too. For one, the thriving car market of the past few years may mean fewer car buyers, period. Used-car sales are likely to grow by just 100,000 vehicles next year, to 12.7 million, according to Paul Taylor, chief economist for the National Automobile Dealers Assn. Worse, the fat margins may be a thing of the past. Thanks mostly to trade-ins from the 0% financing, used-car prices tumbled 6% in 2001, squeezing profits.

All the more reason for dealers to supercharge their efforts to boost revenues in the service and repair business. Last year's slowdown forced some consumers to keep their cars longer. As a result, service revenues at dealerships grew 4%, to \$236 billion even as new-car sales fell 2%. Repair services and parts now make up 10% to 12% of revenues at the big dealer chains.

More important, repairs give dealers their fattest margins. At AutoNation, parts and services bring in just 12% of revenues but 35% of net profits. That explains why dealers like

UTOMOBILES

CAN CAR DEALERS KEEP THE PROFITS ROLLING?

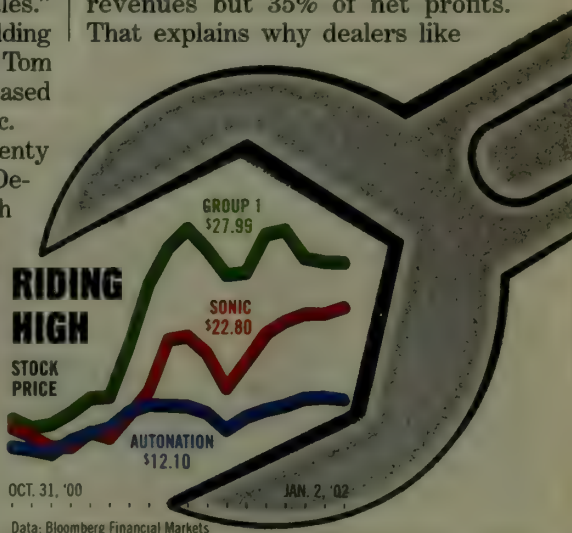
After a banner year, repairs and used cars become the focus

With heavy advertising and good old-fashioned salesmanship, savvy car dealers went all out in December to finish the year with strong sales. The reason for the extra effort: '02 marked the end of the 0% financing deals that Detroit carmakers offered in mid-September to woo buyers. Says Rene Isip, who runs four dealerships in Dallas for Charlotte (N.C.)-based Pontiac Automotive Inc.: "It's the best sales incentive program I've ever seen." He'd better have made the most of it. Even though new programs are being announced—General Motors Co.'s \$2,002 discount, for example—deals as sweet as free financing are unlikely to come around again for a long time. And no one has benefited as much from Detroit's generous promotions as the nation's auto dealers. While the combination of big incentives and a weakening economy decimated profits at the Big Three auto makers, the reverse has been true for large U.S. dealer chains. The incentive-fueled sales boom turned 2001 into one of their best years ever as buyers poured in to take advantage of lower prices. Even Wall Street applauded the dealers' good fortune: Shares of the biggest chains—market leader AutoNation, followed by United Auto Group, then Group 1 Automotive—doubled or tripled last year. With the swooning economy, rising

joblessness, and the end of the incentives all expected to slow new car sales in 2002, the question now is whether dealers' fortunes will stall out, too. Not to worry, says AutoNation CEO Michael Jackson. Used-car sales and the hugely profitable repair business should "offset the obvious decline in new-car sales." But not everyone is convinced. "Building profits will be a difficult task," says Tom Webb, chief economist for Atlanta-based used-car clearinghouse Manheim Inc.

One certainty: 2002 will look plenty different from last year. In 2001, Detroit jacked up incentives through November some 36% over the same period in 2000, to an average of \$2,477 a car, which includes the interest-free offers. The financing break allowed dealers to pump up sales without cutting into their own profits. At the Medford (Ore.)-based dealer chain Lithia Automotive Group, for example, gross margins on new cars jumped to 9.4% in the third quarter, up from 8.7% a year earlier. Lithia expects another uptick in the fourth quarter.

But dealers can no longer count on that windfall this year. New-car sales are expected to fall 10%, to about 15 million. Instead, they are hoping to make up much of the difference with stronger used-car sales, where they book better



Group 1 are investing in new service bays for their dealerships. Says Group 1 Chairman Ben Hollingsworth Jr.: "Service business is why we've performed even in a recession." Looks like he'll have another chance to prove it.

By David Welch in Detroit

RETAILING

HOW HARD SHOULD AMAZON SWING?

Bezos' push for profitability is putting a crimp in growth

Deena Maerowitz, a busy Washington lawyer, had no doubts about where to do much of her holiday shopping this year. When it came to buying gifts, including two Olivia the pig children's books, a bearded-collie calendar, Star Wars games, and two Angel Barbies, she went straight to Amazon.com. A few clicks, and \$150 worth of presents were on their way—no wrapping or waiting in line at the post office required. "I had a great experience with Amazon," she says.

Plenty of holiday shoppers have that same satisfied glow. They snapped up 37.9 million items from Amazon.com Inc. and its merchant partners from Nov. 9 to Dec. 21—22% more than last year, according to the company's Delight-O-Meter online tracking service. As a result, Amazon is expected to meet or beat Wall Street's revenue estimates of \$1.01 billion in the fourth quarter. More important, it should finally achieve the

9%, to about \$3 billion, down dramatically from 69% growth in 2000. A major drag was its core books, music, and video business, where sales dropped 5% in 2001. And unlike Amazon's pro forma numbers—which omit such things as interest expense and restructuring charges—real profitability remains far off. At best, it isn't expected until 2003.

The question is, can Amazon pump up its growth rate while still improving profitability? That depends on whether it can make money off of its expansion into new products, such as consumer electronics, and bolster its business of managing other retailers' online storefronts. If not, Amazon

may end up as just a niche merchant of books, music, and videos. "Amazon hit an important milestone, but it's just that—a milestone," says Mark Rowen, an analyst at Prudential Securities Inc. "They have a long way to go yet."

The e-tailer is making some progress. Electronic gadgets such as DVDs, as well as kitchen appliances and tools, flew out

of its warehouses Christmas, making 19% of sales this year vs. 10% in 1999. Some investors don't know if it is cutting losses in these new categories.

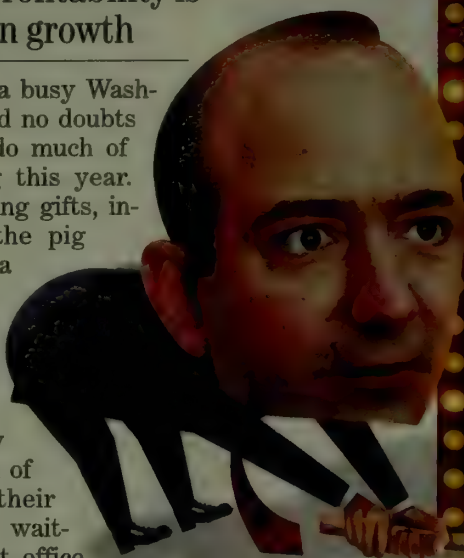
One litmus test is progress in consumer electronics. There were a bright spot in holiday sales this season. Competing with Yahoo! Inc. reports that digital cameras and other such gear helped boost sales 86% at its virtual mall this Christmas. But unlike Yahoo, which simply takes a cut of the sales, Amazon merchants who market via its site. Amazon actually stocks products. So it faces a tough challenge in efficiently managing its merchandise and fulfillment. Gross margins of 10% to 12% don't allow room for error.

Another key area is the performance of Amazon's increasingly important business running online stores and handling order processing for traditional retailers such as Toys 'R' Us, Borders, Target and Circuit City. The unit brings gross margins of 60% and up for Amazon because the partners own the inventory. But it does less for revenue growth, since Amazon books only service fees and a cut of sales. Still, the service revenues were expected to increase 20% in 2001, to \$237.2 million, says Prudential's Rowen. If that trend continues, fulfillment deals could go a long way toward better utilizing Amazon's expensive warehouse investments.

If not, Amazon may have to bite the bullet and shutter warehouses at weaker businesses. But that would cut off its growth prospects. "Unless the services business grows a lot more they can drive substantially more profit out of their products, I am not sure they are a worthwhile investment," says Lauren Cooks Levitan, an analyst at Robertson Stephens.

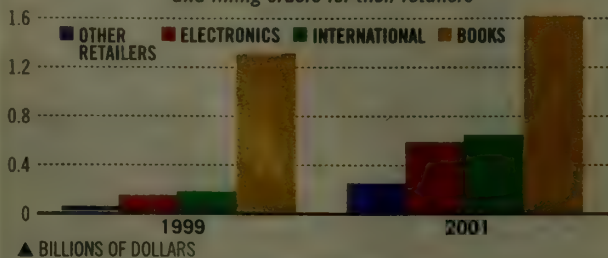
Even if the company is on the right track, most observers expect slow steady progress, not the fireworks of past years. For Amazon, the holidays were fun. Now it's back to work.

By Heather Green in New York



NOT JUST BOOKS ANYMORE

Amazon's latest growth engines: electronics, foreign sales, and filling orders for their retailers



Data: Company reports, Prudential Securities

closely watched pledge of founder and CEO Jeffrey P. Bezos to hit pro forma operating profitability.

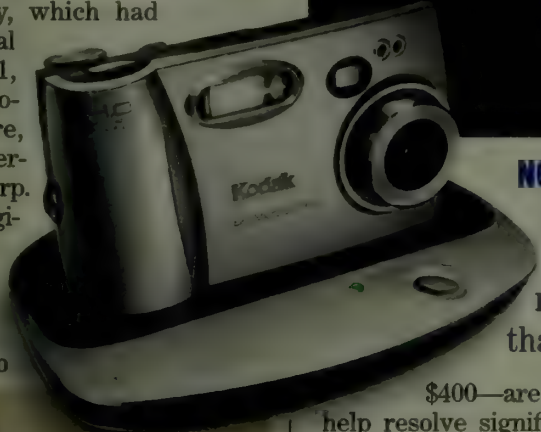
So, is Amazon out of the woods? Hardly. In its bid to reduce losses, it sacrificed sales growth by cutting marketing expenses 17% last year. When the final numbers come in on Jan. 22, 2001 revenues probably will be up just

KODAK IS THE PICTURE OF DIGITAL SUCCESS

Can the fast-selling EasyShare alter its profit outlook?

Digital cameras were in demand this Christmas, flying off the shelves along with Microsoft Corp.'s Xbox game consoles and low-cost DVD players. And the supreme hot seller? No, it isn't Nikon or Canon that came out ahead. Instead, the hit product was from perennial also-ran Eastman Kodak Co. Thanks to its new digital offerings, struggling Kodak was suddenly looking awfully sharp. At Best Buy, Wal-Mart, and countless other stores across the country, Kodak's EasyShare digital cameras, introduced on Apr. 23, were often sold out well before Dec. 25. Says Kodak Chairman Daniel A. Carp: "We'll stay in the game long-term with [EasyShare]."

While the final numbers on 2001 aren't in, EasyShare sales clearly boosted Kodak's market standing. In a December survey of 90 major retailers by Thomson Smith Barney, 50% listed Kodak as their best-selling digital camera, compared with 29% in June. Second-ranked Olympus was a best seller at only about 35% of stores in the December survey, followed by Fuji and Sony. If the trend holds, Kodak will surely gain significantly on Sony, which had 14% of the digital market in 2001, compared to Kodak's 14% share, according to International Data Corp. The Kodak digital cameras—there are five in the product line, ranging from about \$200 to



NOT A SURE SHOT

EasyShare boosted Kodak's market standing, but Carp may have trouble leveraging that result into other areas

\$400—are a hit because they help resolve significant problems that have plagued digital camera owners. These include difficulty downloading images and short battery life.

The timing couldn't have been better. Kodak hasn't had a big hit in a long time—and never has it needed one more than now. The company relies heavily on sales of traditional film to consumers, a business that has been hit hard by both the recession and September 11, as well as the shift to digital photography. Consumers last year cut back sharply on the use of traditional film—by as much as 5%, according to Goldman, Sachs & Co. In recent weeks, analysts have been steadily dropping Kodak's 2001 profits

estimates, to just \$667 million, down more than 54% from the prior year, according to UBS Warburg analyst Benjamin A. Reitzes. Now at \$29, Kodak's stock is 11% off its high last June.

Having a hot new product line will help—though only so much. Digital cameras accounted for just \$500 million of Kodak's estimated \$13.1 billion in sales in 2001. That compares with \$2.6 billion for the declining film business, according to Warburg's Reitzes. As a result, he contends, digital is chipping away at sales of traditional cameras, film, and photo processing services, but isn't yet boosting the bottom line much. What's more, as sales of digital cameras soar, the prices they command are plummeting. As a whole, camera makers sold nearly 9 million units in 2001, almost triple the number they unloaded in 1999. But the average price per camera has fallen to just under \$300, from around \$460 two years ago.

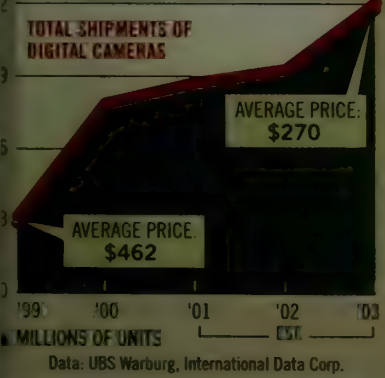
It is also unclear whether Kodak can successfully leverage the popularity of its digital cameras into higher margin ancillary lines. Kodak is eyeing future profits from photo-quality inkjet paper and the company's Ofoto.com online photo sharing and printing service. With 2 million members, Ofoto—one of three photo printing services featured in Microsoft's new XP operating system—is now growing 12% a month.

The home photo paper business may be tougher to crack. Right now, only 15% to 20% of digital images are ever printed. Kodak is banking that EasyShare's simplicity could boost demand for home printing, thus spurring sales of high-margin paper. But that in turn could eat into Kodak's existing sales of paper to printing labs.

Kodak has avoided the intensely competitive home printer market. Instead, it's pushing printing kiosks in retail stores such as CVS and Kmart. Customers can get their own prints by feeding a CD-ROM or memory card into some 24,000 kiosks that Kodak claims have been profitable since 2000. Add it all up, and as big a success as Kodak's EasyShare cameras are, they may not be enough. Keeping the momentum going—and the profits rolling in—will be no easy task.

By Geoffrey Smith and Faith Keenan in Boston

DIGITAL TAKES OFF



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240 laps around the block

Rear-wheel drive

Where's the fire?

1 speed (superfast)

Beans and franks

Not allowed in the street



beyond compare. The Odyssey.  **HONDA** A minivan. Only better.

In Business This Week

EDITED BY MONICA ROMAN

LONG DISTANCE ON THE RISE

THE BIG THREE LONG-DISTANCE companies rang in the new year by hiking some rates and fees to start off 2002, but don't expect the moves to reverse the declines in the traditional long-distance business in recent years. AT&T, Sprint, and MCI Group all increased their "basic" telephone rates, which they charge customers who are not on discount plans. AT&T, for example, will raise the daytime rate it charges for long-distance calls to 35¢ from 30¢. With SBC Communications, Verizon Communications, and other Bells all gaining approval to offer long distance in their regions, however, competition is rising. In addition, wireless companies are offering deals on lots of minutes that include long-distance service. VoiceStream Wireless offers a \$40-a-month plan that works out to 8¢ a minute for long distance during the

week—and includes unlimited calling on weekends for no additional charge.

THE FDA GIVES IMCLONE A HEADACHE

ONE OF THE HOTTEST NEW drugs of 2002 was supposed to be ImClone Systems' Erbitux for cancer—until the Food & Drug Administration rejected the company's approval filing on Dec. 31. The FDA wants more data to back up ImClone's claims for the drug. CEO Samuel Waksal says the requested information will be pulled together in a matter of weeks. But the delay raises concerns that the FDA may demand more clinical trials, delaying the drug's launch until 2003. That would also hurt Bristol-Myers Squibb, which paid \$1 billion to ImClone in September for 40% of Erbitux' profits.

IS ALLSTATE COVERED FOR THIS?

THE FEDERAL GOVERNMENT has accused Allstate, the second-largest auto- and home-insurance company, of violating federal labor law by forcing 6,400 agents to give up their right to sue it for age discrimination or other issues. Under a 1999 reorganization plan, the Northbrook (Ill.) company had converted its insurance agents into private contractors. However, the employees-turned-contractors were required to sign a waiver giving up their right to sue the company over job issues. After a year of negotiations, the Equal Employment Opportunity Commission says it had no other option but to sue to block Allstate from enforcing the waivers. All told, payment for lost wages, job-search expenses, attorneys' fees, and pain and suffering could cost the company \$2 billion, say analysts.

HEADLINER: CHUCK CONAWAY

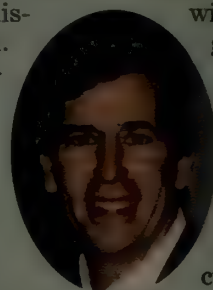
BLUE LIGHT BLUES

WHEN HE WAS HIRED IN June, 2000, as Kmart's CEO, Chuck Conaway said he would need two years to turn the ailing discount chain around. Now, after a disappointing holiday season, some Kmart investors aren't waiting to see whether he will succeed. Kmart shares fell 13.19%, to \$4.74, on Jan. 2, after Prudential Securities analyst Wayne Hood downgraded his rating on the stock from "hold" to "sell" and suggested that a bankruptcy filing could come later in this year.

That's certainly not what Conaway, 41, envisioned

when he joined Kmart from the CVS drugstore chain, where he was president. An operations whiz with a finance background, Conaway has been trying to fix long-standing inventory-management woes. But he admits Kmart paid dearly for its decision to cut back on Sunday TV ads promoting "Blue Light Always" pricing. The retailer says it has sufficient cash and lines of credit for Conaway to pursue his strategy. The possibility of bankruptcy is Hood's "opinion," a Kmart spokesman said.

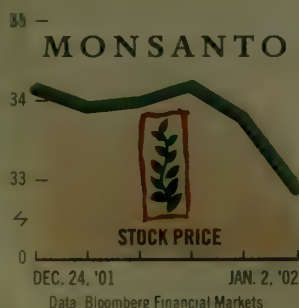
Joann Mul...



CLOSING BELL

CHEMICAL RUNOFF

Monsanto shares fell 3%, to \$32.80, after *The Washington Post* detailed PCB dumping in Alabama by one of the company's chemical units. Monsanto and Solutia—as the unit was named following a 1997 spin-off—deny the action caused any illness or injury and will defend themselves in a trial beginning Jan. 7.



WHY VISIONICS IS FLYING HIGHER

THE WAR ON TERRORISM HAS been a growth engine for Visionics (page 75). On Jan. 2, it announced that seven airports—from Burbank, Calif., to Cincinnati—have placed orders totaling \$350,000 for Visionics' fingerprint scanning system, which allows users to scan prints into the system and transmit them directly to the FBI. Installation is expected to be completed by the end of the month. In the wake of September 11, all airline employees are required to undergo fingerprint background checks.

THE MOUSE THAT SUED ECHOSTAR

WALT DISNEY WON A TEMPORARY restraining order that prevents satellite-TV company EchoStar Communications from yanking Disney's new-

ly acquired ABC Family Channel off its service. The sale is crucial to Disney, which paid \$5.2 billion to acquire the Family Channel from Fox. EchoStar says it needs to drop cable channels to make room for local TV stations it's required to carry and has charged that Disney threatened to lobby against EchoStar's proposed merger with DirecTV if the Family Channel was dropped. Disney says it won't oppose the merger unless EchoStar blocks its TV properties from consumers.

ET CETERA...

- U.S. District Judge Colleen Kollar-Kotelly set a Jan. 7 meeting date with Microsoft.
- Hynix Semiconductor raised chip prices for the third time in less than a month.
- Insurer ACE named PrivateerhouseCoopers partner Phil Bancroft as CFO.

EDITED BY RICHARD S. DUNHAM

ELECTION REFORM LOOKS LIKE A SHOO-IN

Election reform, long ago given up for dead, could well become the first major legislation approved by Congress in 2002. For most of 2001, it was caught up in partisan reminations over dangling chads and bipartisan allegations of te fraud. But the issue seems to have been resurrected by something that happens all too rarely in Washington: a compromise that makes both sides feel like they've won.

For Democrats, the cost of consensus was more than \$2 billion in grants to states to buy modern election machinery and safeguards that allow voters to cast provision-ballots if their names were inadvertently left off the rolls. Republicans signed on in part because the legislation includes significant antifraud provisions. It will require new voters to show a photo ID before casting their first ballot and mandates statewide registration to lessen the chance of someone voting in more than one jurisdiction.

"When similar measures were adopted in Virginia, 100,000 deceased people and 20,000 felonies were removed from the rolls," observes Representative Robert W. Ney (R-Ohio), co-sponsor of the bipartisan House bill. If, as GOP strategists believe, most felons and dead people vote Democratic, the change will benefit the Republicans. "I have great respect for the recently departed and for dogs—I just don't think they should vote," says Senate co-sponsor Christopher S. Bond (R-Mo.).

The House overwhelmingly approved Ney's proposal in December, and Senate Majority Leader Tom Daschle (D-S.D.) promises that a similar measure will be near the top of the agenda when the Senate returns on Jan. 23. With few obstacles remaining, born-again election-reform convert George W. Bush is poised to sign it into law by spring.

Why the rapid turnaround? Chalk it up to a post-September 11 end to the debate over whether the now im-

mensely popular President was legitimately elected. And a news media examination of Florida ballots, which concluded that Bush likely would have carried the state had the Supreme Court not stepped in, "took the pressure off the Republicans to keep this baby bottled up," says Thomas Mann, a senior fellow at the Brookings Institution.

But there are longer-term calculations at work as well. By agreeing to a compromise bill, Republicans can deflect Democratic charges that they are against accurate vote-counting.

And Democrats are likely to benefit from the additional votes that may be tallied in heavily minority precincts. "When this is fully implemented, we're going to add 3 million to 5 million voters," predicts Representative Steny H. Hoyer (D-Md.), co-sponsor of the House bill. The reason for Hoyer's optimism: The most inaccurate voting systems are concentrated in primarily minority precincts in inner cities and rural areas. In Cook County, Ill., for example, uncounted punch-card ballots exceeded 5%.

A cadre of Democratic liberals and pro-reform purists complain that the changes don't go far enough. They are demanding federal standards for voting machinery, a ban on punch-card ballots, and far more money to help recession-ravaged states pay for new equipment.

But the incremental approach seems to have satisfied all but the harshest partisans. The Republicans have a reasonable guarantee that the last election won't become a big issue in the next. And Democrats have a crack at picking up some previously uncounted votes. "One reason this works," says former Representative Mickey Edwards (R-Okla.), now a lecturer at Harvard's Kennedy School of Government, "is that nobody really loses." And in Washington, there's nothing quite so sweet as legislation that has something for almost everybody.

By Dan Carney



RECOUNT: Bye-bye chads?

CAPITAL WRAPUP

FIRING BACK AT ASHCROFT

► Attorney General John Ashcroft wants to give law enforcement every tool to combat terrorism—except, it seems, if it angers the National Rifle Assn. A gun-control group tied to Senators John McCain (R-Ariz.) and Joe Lieberman (D-Conn.) is airing ads protesting Ashcroft's decision to withhold gun-show records from the FBI. Americans for Gun Safety notes that a Hezbollah member in Michigan and a Texan with links to al Qaeda bought submachine guns, rifles, and handguns

at shows this year. The FBI arrested both men on tips after September 11.

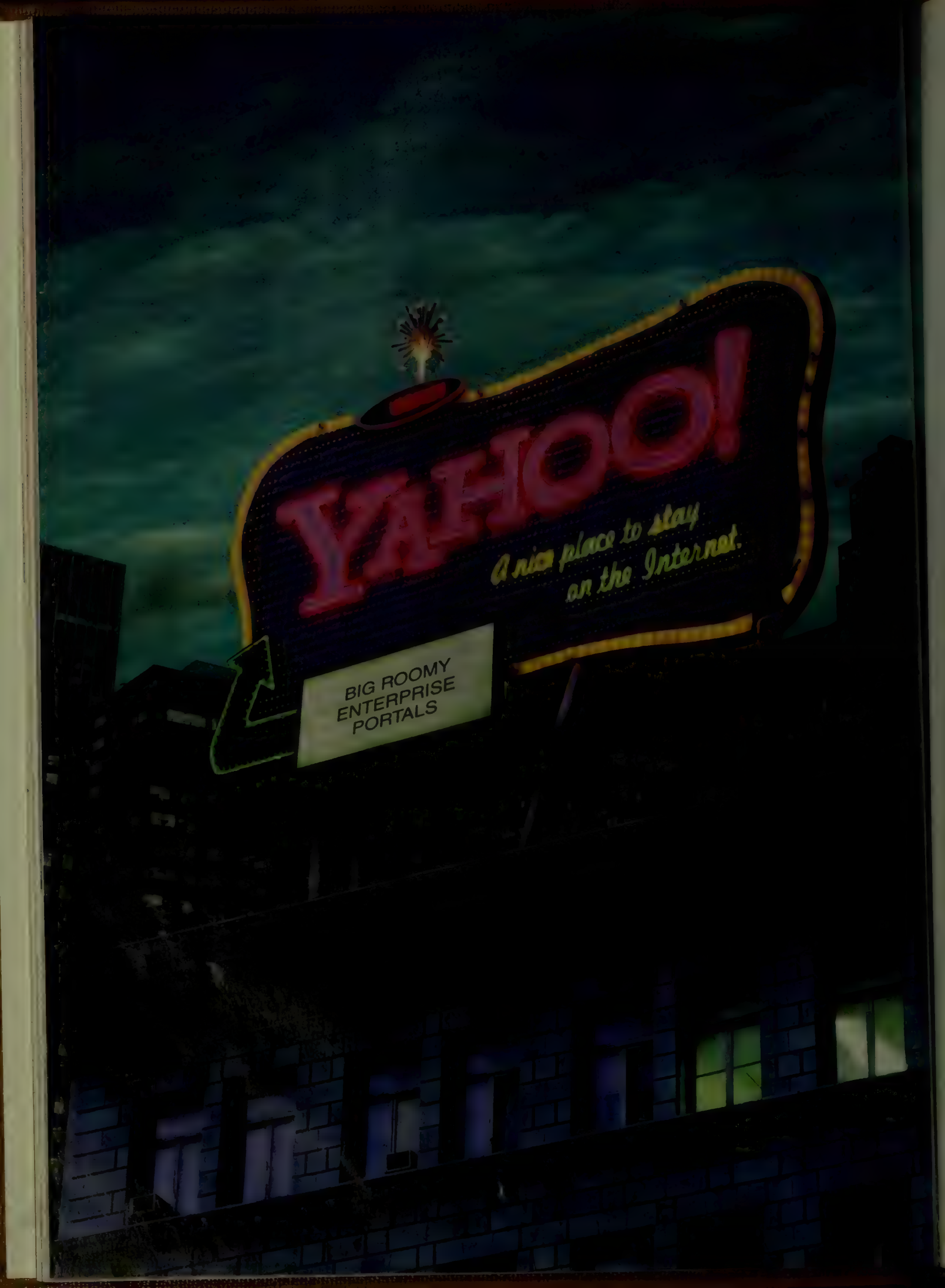
CHIEF OF WHAT?

► The President's Chief of Staff wields enormous power, but the job may not be much of a political springboard. Charlotte (N.C.) venture capitalist Erskine Bowles, a much-admired staff boss in the Clinton White House, lags far behind Republican Elizabeth Dole in the race to succeed Senator Jesse Helms (R-N.C.). An Elon University poll gives Dole a 60% to 13% lead. And Bush's Staff Chief, Andrew Card,

trails former Clinton Labor Secretary Robert Reich in a hypothetical match-up for Massachusetts governor, according to a *Boston Herald* poll. Card says he's not running. Smart decision.

HOLIDAY GOODIES

► The Bush Administration gave business two gifts in the final weeks of 2001. It rolled back one of Bill Clinton's last-minute regs, requiring federal agencies to prove that their private contractors comply with environmental, labor, and other laws. It's also set to publish more business-friendly ergonomics rules.



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RUSSIA

CLEANUP TIME

The Kremlin is launching a major attack on corruption

It was an encounter with Russian President Vladimir V. Putin that Moscow investment fund manager Mattias Westman will not forget. Westman, the Swedish-born director of Prosperity Capital Management, met with Putin in the Kremlin in July to object to the restructuring of Unified Energy System, Russia's electricity monopoly. Westman feared that UES Chief Executive Anatoly B. Chubais could use the plan's terms to sell assets on the cheap to political cronies, thus damaging minority shareholders like Prosperity.

Not to worry, Putin replied—the Kremlin had decided to rewrite the plan to block any such transactions. When a Westman aide asked what Chubais' managers had received in return for accepting this change, Putin answered in a deadpan tone: "I have agreed that they can keep their jobs." With that, Westman recalled, Russia's President nearly fell off his chair laughing.

Jokes aside, Putin is serious about cleaning up Russia. He realizes the entrepreneurial sector can never achieve its potential without a full-scale battle against corruption. What's more, Putin wants closer ties to the West—an initiative that has prompted Putin's cooperation with the U.S. in the fight against terrorism and his resistance to OPEC's call for big cuts in oil exports. But Putin knows that Western invest-

ment will not pour in without a major improvement in corporate governance.

So Putin is leading the Kremlin's biggest crackdown on corruption since the Soviet Union's collapse. A high-profile probe of suspect bureaucrats—as seen in the charges pending against Railways Minister Nikolai Aksyonenko for illegally spending Ministry funds—is making headlines. But a second, less-sensational effort is the heart of this campaign: the drive to limit the myriad opportunities for bribery and pilferage that plague business and government.

Putin's rewrite of the UES restructuring plan is just one example of this so-called structural approach. Another is a new package of reforms, enacted on Dec. 17, that aims to cut down on courtroom bribes by increasing judges' woe-ful salaries fivefold. The new law also bans the intervention of state prosecutors in private litigation between contending business parties.

The Kremlin wants to rein in other bureaucrats, too. New rules demanded by Putin sharply restrict discounts that railroad regulators can give shippers. The discounts often reward customers who cough up the biggest bribes. Another law reduces the number of business activities that require a license from 2,000 to 100: Fewer licenses mean fewer chances for a bureaucrat to get his palm greased. "This will help," says

Alexei N. Mamakov, 27, owner of Neon Art, an outdoor-advertising business in the central Russian city of Kazan. Graft affects "everything and everybody" in Russia, Mamakov says.

The cost of such graft is huge. Russia's reputation as a place where CEOs routinely violate the rights of minority shareholders wipes about \$45 billion off the value of the Russian stock market, estimates Moscow brokerage Troika Dialog. A cleanup could attract an additional \$10 billion annually in foreign direct investment, figures Pricewaterhouse-Coopers. Only \$5 billion a year trickles in now.

Putin has assembled a diverse group of allies in his anticorruption drive and has given each a direct line to his office. The coalition includes Western shareholders' rights activists such as Prosperity's Westman; a crew of liberal policy advisers including Economics Minister German O. Gref and top economic adviser Andrei Illarionov; and the so-called control freaks—law-enforcement leaders including ex-Prime Minister Sergei Stepashin, who now heads the Dur-

watchdog Audit Chamber. "Putin's strategy is to let others fight and bloody the

The Anticorruption Coalition



WESTERN SHAREHOLDER RIGHTS' ACTIVISTS

Moscow investors Mattias Westman, director of Prosperity Capital Management, and William Browder, director of Hermitage

WESTMAN

Capital Management, have worked with the Kremlin to protect minority shareholders in utility UES



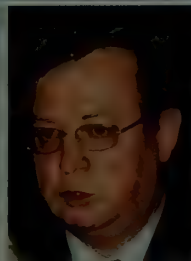
LIBERAL POLICY ACTIVISTS

A crew of Putin firebrands, including economics aide Andrei Illarionov and legal reformer Dmitri Kozak, are seeking to reduce corruption

KOZAK

by cutting back the clout of powerful bureaucrats and increasing the accountability of judges

Data: BusinessWeek

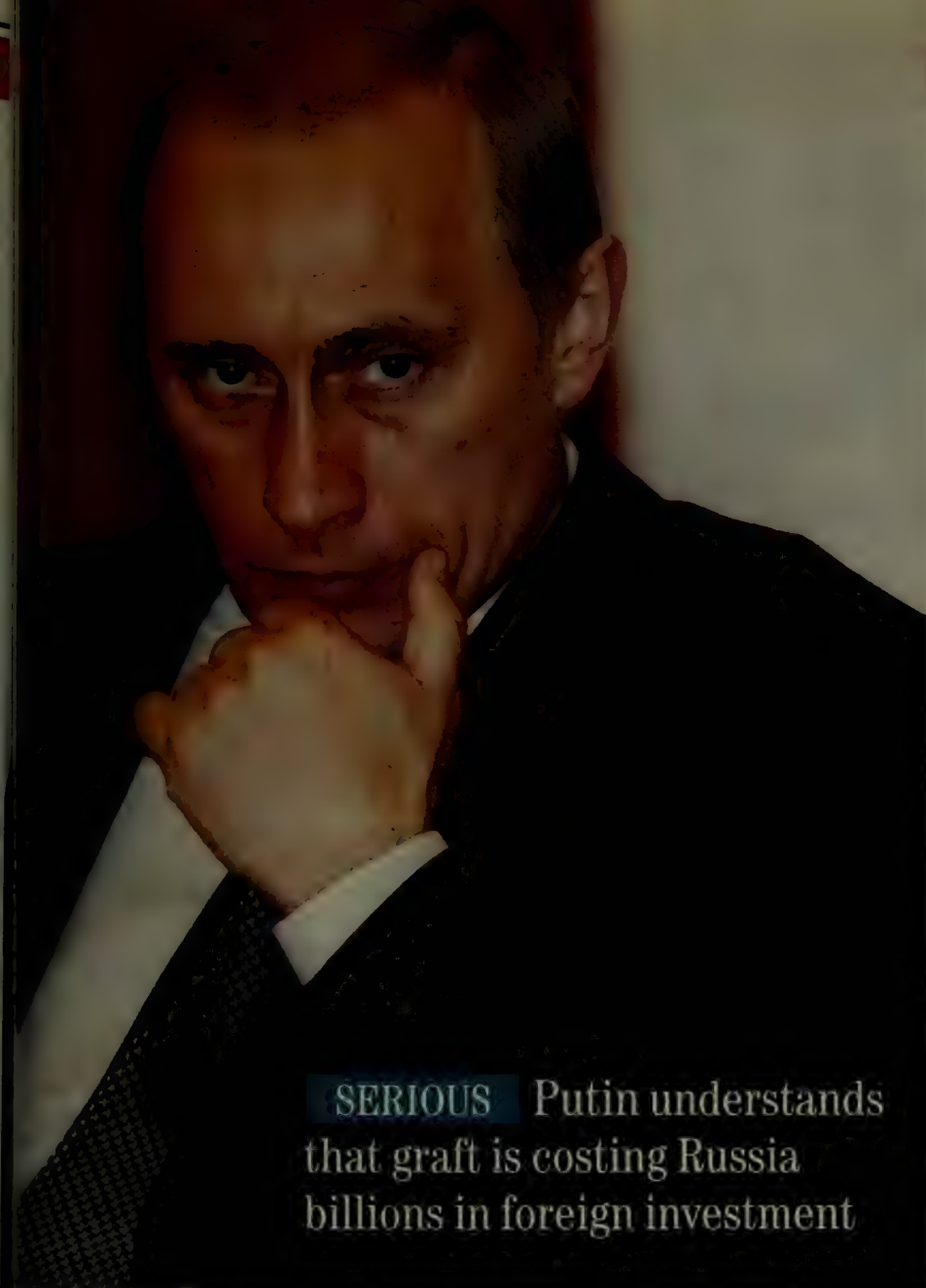


"CONTROL FREAKS"

A group with backgrounds in Russia's security services, including Duma Audit Chamber chief Sergei Stepashin and Duma

STEPASHIN

Kovalev, are investigating budget fraud and other forms of government malfeasance



SERIOUS Putin understands
that graft is costing Russia
billions in foreign investment

lives," says William Browder, director of Hermitage Capital Management in Moscow. "It is smart politics."

For minority investors, the lure of the anticorruption effort is the prospect of higher share prices. That's why Browder earlier this year assisted the Kremlin's efforts to expose shady financial deals at Gazprom, which is 38% owned by the state. With Gazprom management under fire from shareholders and the press, Putin fired Soviet-era CEO Rem Vyakhirev in May. On Dec. 1, the new management decided to reclaim a valuable asset, the Purgaz gas field, which had been pawned off on Vyakhirev cronies. Since Vyakhirev's ouster, Gazprom shares have risen 44%. For the young liberal policymakers, the payoff is enhanced clout. Take 43-year-old St. Petersburg lawyer Dmitri Kozak. Backed by Putin, Kozak got the Duma to ban the involvement of prosecutors in private litigation and limit judges' immunity against corruption

charges. "We are trying to create a transparent judicial system," he says.

For the control freaks, a cadre dominated by ex-KGB officials, the campaign is a way to restore the proper powers of the state in law enforcement—powers these officials believe President Boris N. Yeltsin abandoned during Russia's free-for-all transition to a market economy. Thus Nikolai D. Kovalev, a former head of the Federal Security Service, firmly backs Duma Audit Chamber chief Stepashin's probe into alleged budget fraud in the administration of Mikhail N. Kasyanov, Russia's Prime Minister. Kasyanov would not comment, but an aide maintains the probe is interfering with the work of government.

The crackdown poses several risks. One is that overzealous investigators will trample on civil liberties. Another is that the public, so far squarely behind Putin, turns cynical if it appears that the targeting of rogue officials is selective. Putin, for example, has yet to ad-

ACCESS: *Allies in the anticorruption fight have a direct line to Putin's office*

dress charges by Swiss prosecutors that Pavel Borodin, Putin's former boss in the Kremlin Property Dept., laundered \$25 million in bribes: Russian prosecutors refuse to cooperate. On another front, even Kremlin sources say there is an element of political warfare to the corruption probes, as obscure policymakers who knew Putin from his St. Petersburg years target officials held over from the Yeltsin era.

Wary foreign investors also want to know how stringently the new laws will be enforced. Executives at Sawyer Research Products Inc., an Eastlake (Ohio) maker of electronic-grade quartz, are still reeling from the takeover of Sawyer's facility in the Vladimir region. Two Russian companies seized the facility in July after gaining the support of local prosecutors and judges. Sawyer is appealing its case but is not optimistic. "Kozak's plan to increase judges' accountability is on the right track," says Sawyer CEO Gary R. Johnson. "But it's a question of how fast he can implement it."

As ambitious as Putin's agenda is, there remains a big missing item: the Central Bank of Russia, an institution that combines state regulatory powers with for-profit activities through its stake in Sberbank, Russia's largest commercial bank. "This conflict of interest creates a huge field for corruption," says Dmitri V. Vasilyev, a former head of Russia's Federal Securities Commission. The Central Bank's refusal to disclose just how much it earns from commercial activities, including its treasury bill and foreign exchange operations. Fearful of the bank's political clout, the Duma may not push for reform until the term of the bank's powerful chairman, Viktor V. Gerashchenko, expires in September, 2002. "The Central Bank could be Putin's toughest task," says Vasilyev.

For all the problems, the markets are betting on positive change. Since Putin's election in March, 2000, government bonds have strengthened sharply. Rising oil prices have helped. But bond prices have also picked up because investors figure "Putin has an agenda for cleaning up Russia," says Christopher Weafer, head of research at Troika Dialog. On Dec. 19, Standard & Poor's upgraded Russia's long-term sovereign credit ratings from B to B+, citing such factors as Kozak's legal-sector overhaul. This cleanup will take years. But at least it's starting.

By Paul Starobin and Catherine Belton in Moscow

ITALY

FERRARI'S NEW WHEELS

It's polishing up Maserati for a slightly less affluent driver

A wood fire crackles in the living room of the majestic 19th century Bologna villa that is home to Ferrari Chief Executive Luca di Montezemolo. Leaning back on a plush sofa, the 54-year-old executive sips sparkling wine as he recounts the Italian auto maker's hard-earned victories. In September, Ferrari snapped up its second Formula One race championship in a row and its third consecutive win as best manufacturer of Formula One cars. Off the track as well, 2001 is shaping up to be a memorable year: Operating profits are on course to hit a record \$55 million, on sales of around \$950 million. "What means the most to me is winning the Formula One award for best car-maker," says di Montezemolo, who has trickled much of the advanced racing technology into new road models.

Not bad for a company that less than a decade ago seemed stuck on the sidelines of the sports-car world. Di Montezemolo, a marketing virtuoso and rally driver, took over Ferrari in 1991 at the personal request of Gianni Agnelli, patriarch of the Fiat clan and head of the Fiat group, which owns 87% of the Maranello-based company. Di Montezemolo overhauled Ferrari, luring top talent to the racing team, boosting the quality of its road cars, and jazzing up marketing. Then came the second act: In 1997, Ferrari acquired control of Maserati from Fiat. The Italian sports-car maker's fortunes had declined under foreign owners, and Fiat itself had struggled in vain for four years to turn it around. Now, with new models to launch, "the crucial year for



MASERATI

The Spyder sports a Ferrari-built engine

Maserati will be 2002," says di Montezemolo.

The moment is nigh. On Jan. 7 in Detroit, di Montezemolo will host the U.S. debut of the Spyder, the first of three Ferrari-engineered Maseratis. A convertible that starts at \$85,000, the Spyder boasts a Ferrari-built lightweight V-8 engine, a curvaceous body, and a \$4,000 option for a transmission derived from Ferrari's winning Formula One cars. The car was launched in Europe in September and will land in U.S. showrooms in March, marking Maserati's return to the American market after an 11-year hiatus. A remodeled coupe will be introduced this spring.

Maserati's revival is the centerpiece of di Montezemolo's strategy to rev up

sales from a broader universe of sports-car customers while retaining the high-octane cachet of the Ferrari brand. Critics have praised the Spyder's styling, handling, and features such as a six-speed Formula One-style transmission operated by paddles mounted behind the steering wheel to ease shifting. The Spyder can hit over 175 miles per hour. Its V-8 gives off the same signature howl as Ferrari's roadsters.

In Europe, some 700 Spyders have been sold to date. U.S. orders numbered 500 at last count, including one from American fashion designer and sports-car enthusiast Ralph Lauren. "Maserati gives the market a purebred Italian race car at a price not available with other

brands," says Lauren, who owns a stable of Ferraris. "You have to look at it seriously because it's coming out of the Ferrari world."

But Maserati faces an uphill drive in the U.S., the world's biggest market for sports cars. The economy is in recession and still recovering from the events of September 11. Even di Montezemolo, who drives a snappy mid-blue Maserati 3200 GT coupe with a leather interior, admits "it's not the best psychological moment" to introduce the Spyder. And car buffs may have drifted away from the brand, recalling the quality problems that once plagued it. But all in the past, insists di Montezemolo, who as part of his overhaul of Maserati gutted its 63-year-old brick factory in Modena and refitted it with a cutting-edge mini-production line modeled after that of Ferrari.

Another question is whether di Montezemolo can produce a sedan that can hit in a brutally competitive market segment dominated by BMW, Mercedes, Audi. The Maserati Quattroporte, a four-door sedan, won't be out until 2003, but its features are still top secret. But launching a luxury sedan—which an affluent family may use every day—is a different task from selling a pure sports coupe. "With Ferrari, you have a sports car. But with Maserati, you have something in-between," says a German auto executive. "They have to find a niche for Maserati."

Rebuilding Maserati is also turning out to be a costly venture. The line not expected to turn a profit until 2002 and losses at the unit over the past four years tally up to \$115 million. Some industry experts believe Ferrari's investment in Maserati, expected to total \$343 million through 2006, will yield handsome returns. "They've got an uncut diamond in terms of Maserati's image," says Automotive Industry Data's Schmidt. It's up to di Montezemolo to restore the sparkle.

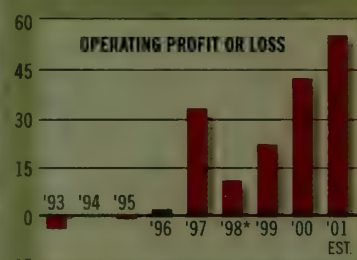
By Gail Edmondson and Christy Tierney in Maranello, with David Weitz in Detroit

COMING TO AMERICA

Di Montezemolo is targeting Porsche and BMW buyers



FERRARI SHIFTS GEARS



▲ MILLIONS OF DOLLARS
* REFLECTS IMPACT OF MASERATI ACQUISITION
Data: Ferrari

COMMENTARY

By Joshua Goodman

ARGENTINA: CAN THE PERONISTS STOP PLAYING POLITICS?

Argentines have made a lot of noise banging pots and pans lately. But that's not because they've been celebrating the arrival of the New Year. Rather, they are protesting as their government disintegrates before their very eyes. First, Radical party President Fernando de la Rúa resigned, a victim of the country's four-year-old economic crisis and inability to avoid a record-sized default on its \$132 billion in debt. Then his successor, Adolfo Rodríguez Saá, stunned the world on Dec. 30 by doing the same, charging he was sabotaged by fellow members of the Peronist party.

Finally, Buenos Aires seemed to

settle on Peronist Eduardo Duhalde as the country's new President. A former Vice-President and two-time governor of Buenos Aires province, Duhalde was the losing candidate in the election two years ago that put the hapless de la Rúa and his now-discredited Radical party in power. Regarded as a potentially strong and charismatic leader, Duhalde has tried to fortify his new government against new crises by insisting that he be allowed to serve out the two years remaining on de la Rúa's four-year term.

De la Rúa, Rodríguez Saá, Duhalde. The world may well find this parade of Argentine Presidents baffling. Wasn't this an economic and financial crisis, not a political one? Shouldn't Argentines be desperately trying to stabilize the situation, instead of hounding Presidents out of office? And why are politicians choosing this, the most perilous moment in Argentina's recent history, to bicker over power?

The answer to these questions—and the key to any solution to Argentina's crippled state—lies in the nature of the

Peronist party. Its turbulent history has often plunged Argentina into crisis. And until the party fixes its own problems, a crisis in Argentina will never be far away.

In this confusing scene, perhaps the most important character is someone not even in the Presidential palace—Duhalde's former boss, Carlos Menem. As President from 1989 to 1999, Menem inherited a political machine that has dominated Argentine politics since the party's founding by General Juan Perón in the 1940s. Peronism ran on a mix of populist policies, nationalism, and lavish patronage. It was Menem's genius to defy the party's protectionism by

launching a drive to privatize industry and peg the peso to the dollar.

The result was a brief run of prosperity, and an end to hyperinflation. But in pulling off his revolution, Menem made a pact with the devil. He kept the Peronists in line by gunning up the patronage machine even more, fueling a rise in government spending at the provincial and national levels that set the stage for default—and an in-

evitable devaluation. Under Menem, as well, corruption flourished, contributing to the mounting popular disgust with Argentina's politicians.

Now the Peronists will have to fix the mess they helped to create. The trouble is, they have no unifying ideology that can guide them. Instead, the party's leaders are obsessed with the Presidential election in 2003, not the here-and-now of Argentina's economic meltdown. In the jockeying for power, no one wants to offend the labor unions and other key constituencies.

Such political calculations leave Duhalde dangerously exposed in any radical step he takes. Any program to revive Argentina's economy, now in its fourth year of recession, must include the measure every politician has resisted: an end to convertibility, the decade-old regime that binds the peso to the dollar. In an early show of bravery, Duhalde has announced his intentions to abandon convertibility, although he has yet to say how he will effect an orderly devaluation. He doesn't have a prayer without the support of his splintered party. The trouble with the Peronists, though, is that many want power, and few want to lead.

Goodman covers politics and economics in Argentina.

No leader has been willing to dismantle Argentina's patronage system

EDUARDO DUHALDE



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HOW, WILL INDIA AND PAKISTAN GET SERIOUS ABOUT PEACE?

For days, the tension mounted. After terrorists attacked India's Parliament on Dec. 13 and India accused Pakistan of harboring groups suspected of staging the assault, troops massed on both sides of the border separating the world's two newest nuclear powers. Yet, by the start of the New Year, it looked as if conflict might be prevented after all.

Bowing to fierce diplomatic pressure from the U.S. and Britain, Pakistan President Pervez Musharraf has begun cracking down on Pakistan-based groups blamed for the attacks—

Jishkar-e-Taiba and Jaish-e-Mohammad, which operate in the disputed Himalayan state of Kashmir that both India and Pakistan claim. He arrested 150 militants and detained key leaders. Indian Prime Minister Atal Bihari Vajpayee still urges Musharraf to close all terrorist camps on its territory and hand over 20 terrorist suspects. And the most skeptical Indians still fear the arrests in Pakistan will prove to be more political theatre than a serious crackdown. Even so, Vajpayee held out an olive branch on Jan. 1, declaring a willingness to “walk more than half the distance with Pakistan to resolve through dialogue any issue.”

Now, from Washington to London to Beijing, political leaders are hoping not only that the two countries avoid war but also that they will take their first serious steps in years toward solving the key problem that divides them—

Kashmir. The struggle to wrest the region from India's control has lasted decades and cost tens of thousands of lives. What's needed now, explains Stephen P. Cohen, an expert on South Asia at the Brookings Institution in Washington, is “a face-saving device that will make it possible for both sides to declare victory.” It's unclear how deeply Washington wants to get involved. But President George W. Bush phoned both Musharraf and Indian Prime Minister Atal Bihari Vajpayee just before the New Year. British Prime Minister Tony Blair is also planning a

peace mission to Islamabad and New Delhi. U.S. ambassadors to both India and Pakistan will likely work actively behind the scenes to push a solution in Kashmir, Cohen predicts. U.S. ambassador to India Robert D. Blackwill was a close Bush foreign policy adviser during his election campaign.

One key to a longer-term solution could be state elections planned for the India-administered part of Kashmir this summer. In the past, India has rigged the elections to keep a New Delhi-friendly government in power. This time, with international attention focused on South Asia,

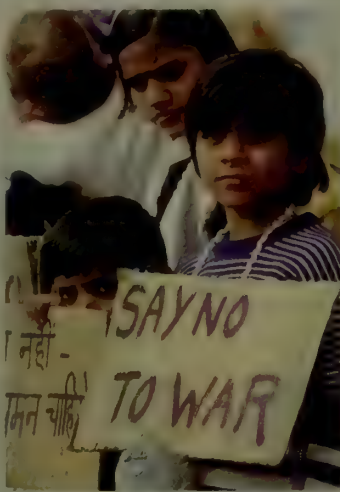
New Delhi could feel pressure to allow free and fair elections in Kashmir.

That would be a step toward easing tensions as well as granting more autonomy for the Himalayan state, especially if Musharraf gives an O.K. for Kashmiri separatist groups to take part in the ballot. Amitabh Mattoo, a member of India's National Security Advisory Board and a professor of international studies at New Delhi's Jawaharlal Nehru University, is advising New Delhi to allow free elections and then open talks with Pakistan on Kashmir's future. Mattoo suggests both countries grant autonomy to their sectors of Kashmir, turning the line of control separating them into a border that Kashmiris could cross without visas.

Would Musharraf buy such a compromise?

He can't appear to be giving up Pakistan's 50-year-old claim on Kashmir without fearing a backlash from his military. Musharraf has already taken heat for reversing his policy of supporting the Taliban. Nevertheless, he has done better than expected in holding his country together since the war in Afghanistan began. If conflict between India and Pakistan can be avoided, Musharraf may surprise once again.

By Manjeet Kripalani in Bombay, with Naveen Mangi in Karachi, Frederik Balfour in Hong Kong, and Paul Magnusson in Washington



PROTESTS in New Delhi

GLOBAL WRAPUP

A ROUGH START IN POLAND

Just a few months after winning power in Poland's Nov. 23 parliamentary elections, the ex-communist Democratic Left Alliance (SLD) government is watching its popularity plummet as economic troubles mount. Unemployment has jumped to almost 8 million, or 16.8% of the workforce, and is expected to exceed 18% in 2002. Meanwhile, economic growth for 2001 lagged at just 1.5%.

That contrasts sharply with new Prime Minister Leszek Miller's promis-

es of a dynamic economy and the creation of 1.5 million new jobs. According to a recent survey by the Warsaw-based Public Opinion Research Center, 67% of Poles say the country is heading in the wrong direction. “Never [since the end of communism in 1989] has our economy been in such bad shape,” says Henryk Wilk, vice-president of the Polish Confederation of Private Employers.

Miller is losing popularity partly because he is taking tough actions needed to get Poland's government budget under control. The Prime Minister has

ordered all his ministers to cut spending to get the 2002 deficit down to \$10 billion, or 5.2% of GDP. That's still above the 2001 deficit of 3.4% of GDP. The government has frozen wages in the state sector, cancelled promised pay increases for teachers, and slashed spending on the army and police.

Budget austerity may also strain the SLD's coalition with the Peasant Party (PSL), which wants more funds for the agricultural sector. With such troubles mounting, it may be tough for Miller to last a full four-year term.

By Bogdan Turek in Warsaw

*Put to the test
by an
unexpected war
and an
unpredictable
recession, the
best executives
rose to the
occasion with
hard-nosed
strategies to
match the times*

Special Report

If there was ever a year in which executives could really distinguish themselves, this was it. Recession, terrorism, war: What didn't go wrong in 2001? Companies already hurt by the sluggish global economy had to contend with the eerie consumer retreat that took place in America after the September 11 attacks. Back in June, executives complained they had "no visibility" on the timing of a recovery; by October, some in the airline and insurance business were hoping the government would see fit to bail them out. Crisis management took on new meaning. It did little good for chief executives to boast about their prospects or deny their mistakes. No one, not investors, not board members, certainly not employees or consumers, was in the mood for that. It was a year to be utterly realistic.

That's not to say the best executives weren't also gutsy, contrarian, or just plain stubborn.

Richard S. Fuld Jr., the head of investment

gic decisions. Gerstner, who will retire this year, changed IBM's business model to focus more on selling services than hardware. It's now the envy of the computer industry. Yoshino also managed an important shift in the direction of his company. Once known mostly for its compact sedans, Honda now produces minivans and sport-utility vehicles. The new models have become so popular in the U.S. that dealers have waiting lists for them. Forget about 0% financing on these vehicles. That's given Honda a market capitalization of nearly \$39 billion, bigger than that of troubled Ford Motor Co.

Another top performer, Tyco International Ltd., now has a market value of \$114 billion—more than Ford, General Motors, and DaimlerChrysler combined—thanks to the relentless dealmaking and lean operating style of CEO L. Dennis

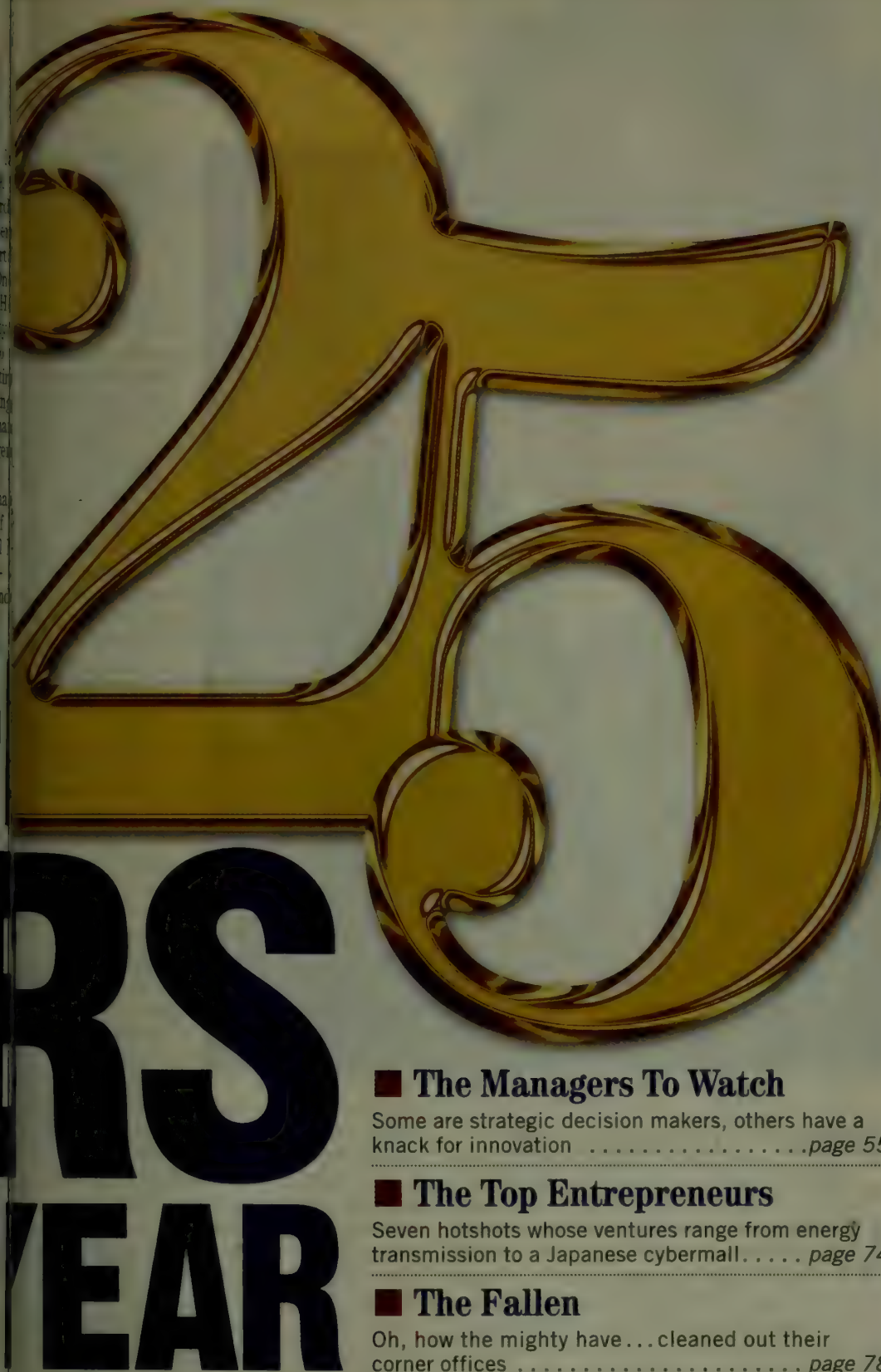
THE TOP MANAGERS OF THE

bank Lehman Brothers Inc., hasn't laid off a soul, even though his rivals have let go of thousands to cut costs. Richard B. Priory, CEO of Duke Energy Corp., was the first to sign a big deal after September 11: He agreed to acquire a Canadian natural gas company for \$8.5 billion. The day after the U.S. began its military campaign in Afghanistan, Howard D. Schultz, the founder of Starbucks Corp., went ahead with an initial public offering in Japan.

To choose the year's 25 Top Managers, *BusinessWeek* surveyed its staff of some 160 writers and editors in New York and in 22 bureaus around the world. Then we culled that list for the truly outstanding leaders. Some, such as Louis V. Gerstner Jr. at IBM and Hiroyuki Yoshino of Honda Motor Co., earned a place because of their smart strate-

Kozlowski. In general, though, stock prices were not the best way to measure an executive's performance in 2001.

In some cases, it made more sense to look at how an executive managed innovation. For example, Steven A. Ballmer, CEO of Microsoft Corp., oversaw the introduction of more major products in 2001—from Windows XP to the Xbox game console—than in any other year. Reuben Mark, who has run Colgate-Palmolive Co. since 1984, has been determined to get new merchandise to markets around



2005 YEAR

■ The Managers To Watch

Some are strategic decision makers, others have a knack for innovationpage 55

■ The Top Entrepreneurs

Seven hotshots whose ventures range from energy transmission to a Japanese cybermall. page 74

■ The Fallen

Oh, how the mighty have... cleaned out their corner offices page 78

the world as quickly as possible. Although Colgate sells brands of soap and toothpaste that are decades old, more than a third of its revenues come from goods introduced in just the past five years. And at online auction site eBay Inc., Margaret C. Whitman continually responds to users' requests for new categories and features. Now, eBay even offers red-price items for sale.

While some of our managers, such as Colgate's Mark, rarely appear in public, others put themselves right out there. John Browne

of BP PLC is a modern-day oil baron and industry pacesetter who also talks about the dangers of global warming. And Oprah Winfrey, whose television show and magazine are still drawing converts, presided over a memorial service in New York's Yankee Stadium attended by 20,000 people. Sure, Winfrey is comfortable in front of a big audience: She has 26 million viewers in the U.S. alone. But we like to think that any of this year's top managers could have stood next to Mayor Rudolph W. Giuliani and still looked good. ■

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THE TOP MANAGERS

25



Louis V. Gerstner Jr.

■ IBM

When IBM named Louis V. Gerstner Jr. chairman and chief executive on Apr. 1, 1993, the computing giant had one foot in the grave. Bloated from its patrician culture and outflanked by more nimble rivals, IBM was on the verge of a breakup. But now, as the 59-year-old veteran of RJR Nabisco and American Express Co. gets ready to retire, IBM is alive and kicking. Its services-heavy business model is the envy

of the computer industry, and it has regained leadership in key markets where it had lagged, such as servers, software, and storage devices. While the tech industry imploded in 2001, Big Blue is on track to report \$7.7 billion in profits for

the year, down slightly from \$8 billion in 2000. Revenues should be \$87.4 billion.

Gerstner made two key decisions that have continued to pay dividends. First, he reversed the plan to break up the company. Good thing: Last year, IBM's global reach and diversity buffered it from the tech downturn. Second, he made a huge strategic bet on the services business, shifting the company away from its roots as a maker of Big Iron and PCs. In 2001, IBM Global Services was the biggest fastest-growing part of the company, with 43% of sales.

Gerstner does not chitchat. The Mineola (N. Y.) native and Harvard Business School grad surrounds himself with a close circle of loyal advisers. He tra-

vels constantly to keep in tune with customers' needs, and in meetings, associates say he zeroes in on the main issue. Still, he makes time for various social causes, especially those that stress the importance of public schools. In June, he became an honorary Knight of the British Empire for his advocacy of education. "Lou is an incredibly focused executive," says Symantec Corp. Chairman John W. Thompson, a former general manager of IBM's North American Sales Group. "He makes it very clear to everyone what his expectations are."

Now, Gerstner's great run is nearing its end. His contract expires on Mar. 31, and he is expected to step down soon after. Waiting patiently in the wings is President and Chief Operating Officer Samuel J. Palmisano, 50, an IBM veteran who has sharpened the giant's day-to-day operations. Thanks to Gerstner, Palmisano will be taking over a healthy and powerful company. He just has to keep it that way.

KEY ACCOMPLISHMENTS

■ Services should bring in \$5.3 billion profit on \$35.7 billion in revenue

■ The stock was up 45% as of Dec. 28, vs. an 8% loss for the S&P 500

Howard Schultz

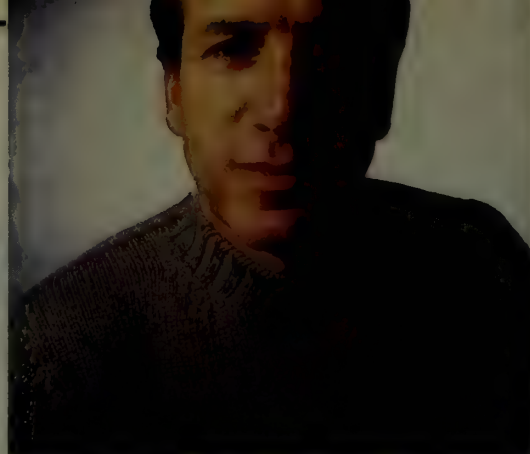
STARBUCKS

Just one day after the U.S. military began bombing Afghanistan, Starbucks Chairman and chief strategist Howard Schultz was on a plane to Tokyo for an initial public offering of his company's shares on the Japanese market. True, the shares are down some 14%, but it was a risky move.

For the 48-year-old Schultz, it has been a kind of year. While other retailers saw sales plummet in the wake of the terrorist attacks and a slumping economy, Starbucks led out 1% monthly comparable store sales. The Seattle company now has

matched 121 consecutive months of positive comp sales—a rare industry measure—since it went public in 1992.

Starbucks started in 1987 with just 16 stores; today it serves nearly 20 million people a week



from nearly 5,000 outlets. And Schultz wants to expand his coffee empire: In the midst of a worldwide economic downturn, he plans to open more than 1,000 stores from Beijing to Vienna in 2002. Schultz, who grew up in public housing in Brooklyn, N.Y., believes his \$3 latte is recession-proof.

He had better be right. To keep investors happy, the company needs earnings growth of 25%, not the 15% it is currently project-

ing. And while Starbucks is a hit in Asia, Europeans are a different story. Schultz needs to seduce the Continent with American marketing, just as he wooed Americans with European coffee a decade ago.

KEY ACCOMPLISHMENTS

■ Profits grew 92%, to \$181.2 million, on sales of \$3 billion for fiscal year ended in November

■ Posted 121 consecutive months of positive comparable-store sales since it went public in 1992

Fujio Mitarai

CANON

By Japanese CEO standards, Canon Inc.'s Fujio Mitarai is something of an anomaly.

For starters, he's fast and decisive—a far cry from the consensus builders who typically run Japan Inc. Just months after his appointment as president and chief executive in 1995, he shocked senior managers by killing Canon's large personal-computer division.

Today, Mitarai is being held up as a model for other Japanese executives. Gone is Canon's obsession with sales and market share at any cost. Says Mitarai, 65: "I put profits first." He has shut down four divi-

sions and revamped inventory control.

Those moves are paying off. Canon's printer and copier business is booming, providing the bulk of sales. While many Japanese blue chips have had to head for cover, Canon's 2001 net income is expected to rise 23% over the previous year, to \$1.26 billion, on sales of \$22 billion, up 4%. Moreover, Mitarai has built up a cash stash of some \$765 million since taking over.

Mitarai is the nephew of one of the founders of Canon, but he earned his promotion by launching explosive growth at the company's U.S. operations. When he was recalled to Japan in 1989, Mitarai was reluctant to go. "I had different business standards and found Japan too irrational," he says. Now he's proud to have made Canon more global and profit-oriented. If only the rest of Japan Inc. would follow.

KEY ACCOMPLISHMENTS

■ Cut money-losing product lines, nearly doubling net income to \$1.26 billion in 2001, since taking over in 1995

■ Boosted Canon's share of the global digital-camera market to 14% in 2001, from 9% the previous year

MANAGERS TO WATCH

2·0·0·2

Richard Parsons

AOL TIME WARNER



The surprise pick to succeed CEO Gerald M. Levin, Parsons, 53,

faces a lot of heavy lifting. He has to revive the music business, roll out broadband services, and restore credibility with Wall Street. That's on top of maintaining harmony among the company's fiefdoms.

Jeffrey Immelt

GENERAL ELECTRIC

Jack Welch's successor has big plans, including more acquisitions



and better customer focus. He also vows to boost diversity at the top. Meanwhile, Immelt, 45, has to keep up GE's double-digit growth in a sputtering economy. The airline slowdown could make that difficult.

Lawrence Bossidy

HONEYWELL



Bossidy, 66, came back from retirement to stabilize things after the col-

lapse of Honeywell International's planned merger with General Electric Co. Now, the recession is forcing him to slash costs and dump businesses. But his main job is finding a successor before he leaves again this summer.

THE TOP MANAGERS

25



Oprah Winfrey

■ HARPO

In the aftermath of September 11, Oprah Winfrey didn't miss a beat. The Queen of Talk quickly adapted, changing her regularly scheduled programming on *The Oprah Winfrey Show* to a series—"America Under Attack"—exploring tough issues that gripped the nation, including "How to Talk to Kids" and "Is War the Only Answer?"

During the week of Sept. 17, the first week for which Nielsen Media Research collected data after the attacks, the talk show ranked No. 3 among syndicated television programs—one slot better than the previous year's ranking during the same week.

Later, the head of Harpo Inc. flew to New York to

preside over an in-faith ceremony at Yankee Stadium. At its conclusion, she told the mourning crowd of 20,000: "I believe when you lose a loved one, you get an angel whose name you know."

Oprah Winfrey, 41, is in the business of soothing souls. The magic is what has kept her program at the top of the talk-show charts in 2001—a perch it has held for 16 consecutive seasons. The show generates more than \$300 million in annual revenues and reaches 26 million viewers in the U.S. each week—plus millions more in 106 international markets. This season's show, which started in September, is leading its closest daytime talk competitor, *Live with Regis and Kelly*, hosted by Regis Philbin and Kelly Ripa, by 66%.

Sure, Winfrey sometimes misreads her audience—the

film *Beloved*, which she starred in and produced, flopped at the box office. But disappointments are few. Winfrey, a hands-on manager if there ever was one, has kept her wildly successful *O, The Oprah Magazine* soaring even in a dismal economy. Guaranteed circulation has grown from 1.3 million in January, 2001, to 2 million today. The magazine's mix of consumerism and self-empowerment resonates. And her "Live Your Best Life Tour," a series of four day-long seminars in June, offered participants a mix of spiritual encouragement and down-home wisdom. Even at \$185 a ticket, events sold out in hours. After all this time, people still can't get enough of Oprah.

KEY ACCOMPLISHMENTS

■ *The Oprah Winfrey Show* was the top-rated talk show for the 16th year

■ *O, The Oprah Magazine* has grown from 1.3 million in circulation in January, 2001, to 2 million today

Robert A. Eckert

MATTEL

If you have a little trouble finding a *Harry Potter* action figure this winter, Robert A. Eckert is the man to blame. Mattel Inc. had already acquired the license to produce the toys when Eckert, 47, came as chairman and chief executive in May, 2000. The former head of Kraft Foods Inc. quickly put his own understated touch on the rollout. Eckert wanted to keep the product line simple, so Mattel eliminated 25% of the toys that were originally planned. Eckert also aimed low, budgeting to sell just a quarter of the \$400 million worth of toys sold after the last *Star Wars* movie. With *Potter* merchandise already out of stock at many stores, Eckert says Mattel could easily reach his sales forecast.

Eckert has been underpromising and overdelivering since he joined Mattel. He gave away Mattel's money-losing Learning Co. computer-me division, ended



a pricey movie-licensing agreement with Walt Disney Co., and cut jobs. Brian P. McGough, an analyst at Morgan Stanley Dean Witter & Co., expects Mattel's 2001 earnings to climb nearly 16%, to \$341 million, on just a 3% sales increase, to \$4.8 billion.

Eckert is working to make Mattel even more efficient. He asked the distribution staff to spend more time with big cus-

tomers such as Wal-Mart Stores Inc. and Toys 'R' Us Inc., and that cut delivery times. These smart moves are what's keeping Eckert ahead in this game.

KEY ACCOMPLISHMENTS

- Mattel made money again in 2001
- Turned the much-hyped *Harry Potter* into a potentially enduring toy franchise

Richard S. Fuld Jr.

LEHMAN BROS.

Richard S. Fuld Jr., chairman and CEO of Lehman Brothers Inc., is pretty good at proving naysayers wrong. Ever since American Express Co. spun off Lehman in 1994, Wall Street insiders have speculated that Lehman, the fourth-largest traditional investment bank, couldn't stay independent for long. The firm suffered a setback on September 11: One Lehman employee was killed, its headquarters building near Ground Zero was severely damaged, and its market share fell, as reflected in its fourth-quarter results.

But these blows have only made Fuld and his team more determined to expand Lehman's reach. "In a sad, peculiar way, I'm reenergized by all that's happened. It was that horrible, unfortunate event that got my people to come together in such a strong way," says

Fuld. And that is largely because of his straight-shooting, gutsy, contrarian leadership style. While rivals are laying off thousands to cut costs, Fuld, 55, who started with Lehman as a commercial-paper trader in 1969, insists he will keep his staff intact and hire new talent.

Even with the recent troubles, it was a dazzling year for Fuld. Lehman gained market share in global debt and equity issuance, and its market cap held steady as rivals saw theirs sink. Some Wall Street insiders speculate that Fuld will buy a clearing or asset-management firm to keep Lehman on its upward trajectory. Fuld says he is not against making a purchase that will boost return on equity. But he adds: "It would have to be a terrific deal because it would be destabilizing. I have my team doing exactly what I want them to do." Even the naysayers would have to agree.

KEY ACCOMPLISHMENTS

- Stock is up tenfold since it was spun off from American Express in 1994
- Increased global market share for debt and equity issuance from 5.5% a year ago to 6.5% in 2001

MANAGERS TO WATCH

2·0·0·2

William Clay Ford Jr.

FORD MOTOR



Ford, 44, insists he never sought the CEO job at the carmaker. It's not

an enviable position: car quality, factory productivity, and market share all are suffering. Employee morale is poor, as are relations with suppliers and dealers. Ford must make peace as he prepares a major restructuring.

Douglas Daft

COCA-COLA

Daft still hasn't put the fizz back in Coke. Sprite and Coke Classic



remain flat despite a \$300 million marketing boost. And Daft, 58, pulled the plug on his own deal to co-produce juice drinks and snacks with Procter & Gamble Co. Coke's star-studded board will be patient only so long.

Christopher Galvin

MOTOROLA



This ought to be the year of reckoning for Galvin, 51. Motorola is expected

to report an operating loss for 2001—its first in 71 years. Galvin is reinvigorating the company's wireless phone business. But to save his job, he'll also have to do better with semiconductors and network gear.

THE TOP MANAGERS

25

Daniel Vasella

■ NOVARTIS

For Novartis Chairman and CEO Daniel Vasella, running the world's seventh-largest pharmaceutical company isn't very different from his previous career as a hospital physician. "You need to make a quick diagnosis, determine the urgency of the situation, and surround yourself with a competent team," says Vasella, 48, who is known as an extremely demanding, very direct boss. Vasella has transformed the once-stodgy Swiss conglomerate into an aggressive innovator. In the past year alone, Novartis has launched four new drugs, most notably Gleevec, a breakthrough cancer treatment. It

also bought a 20% stake in Swiss archrival Roche Group and pioneered programs to prove global access to costly new medicines.

Novartis' metamorphosis began six years ago, when it was formed through the merger of Swiss drugmakers Sandoz and Ciba-Geigy. As head of Sandoz's pharmaceutical unit, Vasella, who skis, motorbikes, and collects rare books in his spare time, quickly overhauled the culture of the new company. He introduced performance-linked compensation, beefed up marketing, and boosted research and development spending by 40% from 1996 to 2000. In 1999, he ditched the agrichemicals business to focus on the more lucrative pharmaceuticals market.

Those early moves paid off. Sales in the U.S., where Novartis derives 40% of its revenues, were up 25% through the first

KEY ACCOMPLISHMENTS

■ Launched Gleevec, a breakthrough drug for leukemia, just 32 months after entering clinical testing

■ Increased sales for 2001 by 14%, to \$13 billion, and is on track to boost operating profits by 5%, to \$4.2 billion

nine months of this year, to \$4 billion. Meanwhile, worldwide drug sales were expected to reach \$13 billion in 2001, up from \$10.7 billion in 2000.

With growth prospects strong, Vasella is now launching innovative programs to improve patient access to drugs. Beginning in January, Novartis will offer discounts of up to 40% on all its drugs to the estimated 11 million elderly Americans without prescription coverage. And Gleevec, which typically costs around \$24,000 a year per patient, is being offered in the U.S. for free to the poor and on a sliding income scale to middle-class Americans. Vasella also is working on initiatives to improve access to drugs in the developing world. Novartis is providing financial assistance programs for Gleevec, donating leprosy medicine, and selling malaria drugs at cost in poorer countries.

Still, Vasella's top goal is to have the company's shareholders earn a return on their investment. Government interference with drug patents has made them nervous, and pushed down prices for the shares of Novartis and other drugmakers. But with healthy profits in the bank, Vasella can afford to feel charitable these days.

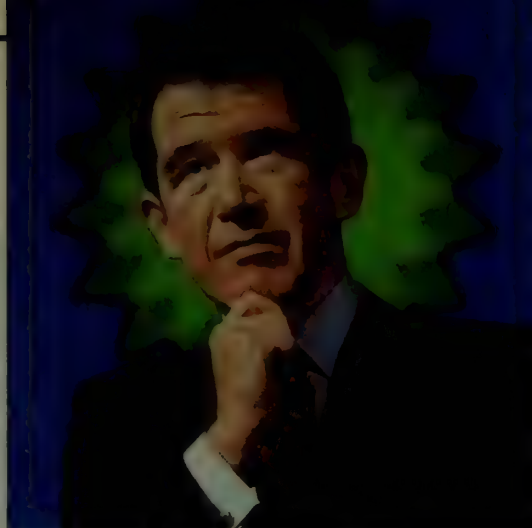


John Browne

BRITISH PETROLEUM

John Browne lights up a rich Cuban cigar in his London office as he reflects on the year. The CEO of BP PLC has plenty reasons to be satisfied. Browne, a bachelor, is about to move into an Edwardian house in Cambridge that he has been lavishly renovating. And he looks forward to several years of refining what is already a formidable profit machine.

Many people in the oil patch consider Browne, 53, to be the industry pacesetter. A decade ago, BP was a struggling midsize company short on earnings and clout. But Browne, who was promoted to CEO in 1995, has been instrumental in transforming it into the world's second oil company, behind Exxon Mobil Corp. His \$57 billion acquisition of Chicago-based Amoco in August, 1998, triggered a huge wave of industry consoli-



dation. Browne then bought Arco in 1999 for \$25 billion. These groundbreaking deals are more than paying for themselves. BP's profits for the first nine months of 2001 were up 9%, to a record \$10.97 billion, despite weaker prices.

Browne's gutsiness sometimes draws flak. His warnings about the dangers of global

warming have annoyed some environmentalists, who consider such talk from an oilman to be hypocritical. Lately, Browne has been quiet, but the industry watches his every move for clues about the future.

KEY ACCOMPLISHMENTS

■ Germany approved BP's bid for Veba oil, making BP that nation's marketing and refining leader

■ Solidified BP's position in the fast-growing Chinese market, with a \$2.7 billion joint venture there

Kent Kresa

NORTHROP GRUMMAN

Chairman and Chief Executive Kent Kresa had just closed on a \$5.1 billion merger with Litton Industries last spring when rival General Dynamics Corp. launched a surprise attack, announcing it was buying Newport News Shipbuilding & Dry Dock Co. The deal would make GD the dominant player in military shipbuilding, a business Northrop had just entered. Kresa decided to fight back.

Rather than start a bidding war, he offered to match GD's price and began a campaign to convince regulators that a GD/Newport News deal was anti-competitive. The strategy worked. In October, the Justice Dept. sued to block the GD merger. By December, Newport News

was Kresa's. "He is low key, but effective," says Jon B. Kutler, a defense industry investment banker at Quarterdeck Investment Partners LLC. "He's the stealth CEO."

Indeed, Kresa, 63, has never sought a high profile. But during the industry contraction of the past 10 years, Northrop has grown from an also-ran into the nation's No. 3 defense contractor, with \$18 billion in sales projected for 2002. And he's recently helped win lucrative government contracts. "Our mission has been to look where the growth is and be one of the survivors," says Kresa.

Kresa grew up in a show-biz family. His father, Helmy Kresa, was songwriter Irving Berlin's chief assistant, and young Kent was a child actor. He gave up the bright lights to attend the Massachusetts Institute of Technology. "I couldn't stand the rejection," he says of auditioning. Lately, that's one thing he hasn't had to worry about.

KEY ACCOMPLISHMENTS

■ Completed the defense industry's two biggest mergers in 2001

■ Helped win funding for major new programs, including the F-22 fighter and the Joint Strike Fighter

MANAGERS TO WATCH

2·0·0·2

Michael Eisner

■ DISNEY



Eisner, 59, must revamp Disney after ratings at ABC fell and theme-parks

attendance dropped. To cut costs, he closed the GO Web network and is shuttering nearly half of the company's U.S. stores. Eisner could be fending off unwanted suitors if he can't get that Zip-A-Dee-Do-Dah back.

Carly Fiorina

■ HEWLETT-PACKARD

Fiorina, 47, is in a battle for survival.

Her sweeping reforms failed to improve HP's performance in most of its markets. And her acquisition of Compaq Computer Corp. is on the ropes. Even if she wins and the deal goes through, Fiorina has to execute flawlessly on the biggest tech merger ever.



Michael Capellas

■ COMPAQ



Capellas, 47, shocked the world when he agreed to merge Compaq with

Hewlett-Packard Co. and play second fiddle to Carly Fiorina. If they somehow save the deal, he has the tough job of merging the operations. If it fizzles, he'll need another surprise to convince investors that Compaq can go it alone.



THE TOP 25 MANAGERS



Carole Black

■ LIFETIME ENTERTAINMENT SERVICES

Carole Black knows what women want. Since Black, 58, became president and CEO of Lifetime Entertainment Services in March, 1999, she has turned Lifetime TV into the year's top-ranked cable network in prime time. Suddenly, its earnest and uplifting portrayals of women achieving against the odds are beating out CNN, ESPN, and USA Networks, and a host of

other hot rivals. Black has tripled the network's programming budget to about \$300 million for 2002, doubled the marketing budget, and revved up campaigns such as breast cancer awareness to boost the brand. And advertisers are buying plenty of time on Lifetime

TV, which reaches 10 million homes, even as they curtail spending elsewhere. No wonder Black feels the world is ready for yet another Lifetime brand. She recently launched a documentary channel called Lifetime Real Women to supplement the main network and its movie channel.

Not bad for a network work once known for its maudlin the-woman-did-it-her-wrong themes—or for Black, the girl voted most likely to succeed at her Cincinnati high school. Raised by her Armenian grandparents after her parents' divorce, Black has done everything from writing a "Dear Carole" advice column for truckers to heading up KNBC in Los Angeles, where her clever marketing made it the top-ranked station.

At Lifetime, Black comes across as a tough but loving big sister, with convers-

tions swinging from diets to demographic to dating—without missing a beat. It's the kind of banter she loves to see on her hit shows, which include *The Division*, about female detectives, and *Strong Medicine*, set in a women's health clinic. "We're not into fantasy," says Black. "Our shows and our characters have to feel real." She adds that Lifetime's down-to-earth tone, and its potential to make girls and women feel terrific about themselves, is what drew her to this Walt Disney Co./Hearst Corp. joint venture. And, of course, who could pass up the chance to take on the big boys of broadcasting? Having conquered cable, Black would love to make Lifetime the ratings queen of the entire dial. That's a big call, given that cable still draws a fraction of the viewers of network TV. But Black has proven that TV for women can be mainstream.

KEY ACCOMPLISHMENTS

■ For most of 2001, Lifetime was the No.1 basic-cable network with households in prime time

■ Revenue should reach \$715 million in 2001, up from \$550 million in 2000

Barry Lam

QUANTA COMPUTER

You want to rile Barry Lam, the founder and chairman of Taiwanese notebook PC producer Quanta Computer? Call his company a contract manufacturer. The tag might seem apt. Like rivals Solectron Corp. and Celestica Inc., Quanta produces gear for some of the biggest names in the tech universe, including Dell. But Quanta is also the world's biggest producer of notebooks because, Lam says, of its expertise in design and supply-chain management. In his view, that puts Quanta in a different league than, say, Solectron. "They are contract manufacturers," he sniffs. "We are flexible manufacturers."

Lam, 52, has reason to be cocky. While 2001 was a year to forget for almost everybody in the PC world, it was terrific for his 13-year-old company. Sales will likely hit \$6 billion, up 50%



from 2000, with earnings up 25% to \$310 million. And, while some analysts doubt Quanta can maintain its torrid pace, Lam predicts sales will hit \$5 billion in 2002 and \$10 billion by 2004.

Lam is now diversifying into servers, storage, and liquid-crystal display terminals. He's also shifting production to China, where he expects to slash costs by 10%. His next dream: to open an art museum. But the former pocket-calculator salesman admits that he remains a "product guy" at heart.

And he bets that diversification and innovation will keep this flexible manufacturer flush for years to come.

KEY ACCOMPLISHMENTS

- Stock price up 70% as of Dec. 28 while Taiwanese market rose 9%
- Diversified base by shifting manufacturing to China and expanding into new, higher-margin products

Dennis Kozlowski

TYCO INTERNATIONAL

Dennis Kozlowski is known as perhaps the most aggressive dealmaker in Corporate America. But in 2001, the CEO of Tyco International Ltd.

stood out for leading his company through a recession that flattened most of its counterparts. Despite the downturn, Tyco's earnings before extraordinary charges soared 38%, to \$5.1 billion, for the

fiscal year that ended Sept. 30.

Kozlowski, 55, has steered Tyco into such recession-resistant businesses as health-care

products and security systems. That helped offset a downturn in Tyco's \$13 billion electronics operations. Sales are still falling, but Kozlowski moved fast last year to slash 11,500 jobs and cut annual costs by \$350 million.

Kozlowski—who has done \$62 billion worth of deals since 1992—bagged his most surprising prey in June: CIT Group, then the nation's largest independent commercial-finance company. Critics scoffed, saying Tyco would get burned venturing into an unfamiliar business just as the economy was souring. But so far, profits are up, thanks to Kozlowski's decision to jettison some \$5 billion in underperforming CIT assets and trim \$150 million in administrative costs. Kozlowski vows Tyco's earnings will once again grow by more than 20% a year. That would bring him closer to his ultimate goal: inheriting the mantle once worn by Jack Welch.

KEY ACCOMPLISHMENTS

- Diversified into financial services by acquiring CIT Group for \$10 billion
- Sales increased 25%, to \$36 billion, in the fiscal year ended Sept. 30

MANAGERS TO WATCH

2·0·0·2

Abigail Johnson

FIDELITY



Johnson, 40, has the toughest job in the fund industry. In May, she was

named president of Fidelity's mutual-fund unit. She is in line to succeed her father, Chairman Edward C. "Ned" Johnson III, 71, when he retires. But if Fidelity's funds perform poorly, her ascent will be tarnished.

Jack Greenberg

MCDONALD'S

Greenberg, 59, earned a spot in the history books in 2001



when he became the first McDonald's CEO to preside over four quarters in a row of declining profits. A repeat in 2002 and Greenberg may be history, too. His big problems: Mad-cow disease scares overseas and poor service at home.

Rick Braddock

PRICELINE



Braddock, 59, salvaged a third-quarter profit and bolstered Priceline's

stock by buying 750,000 shares. Its travel sales are hovering around pre-September 11 levels. But Priceline needs to sell enough mortgages, cars, and long-distance minutes to prove it can be a high-growth business.

THE TOP MANAGERS

25

Jeffrey L. Bewkes

■ HOME BOX OFFICE

The real Mr. Big at HBO is not the character on the hit comedy *Sex and the City* but Chief Executive Jeffrey L. Bewkes. In his six years at the helm, Bewkes has built the cable network into one of the hottest properties on TV, and things only got better in 2001. Shows such as *The Sopranos* and *Sex and the City* continued to draw praise as did newcomers *Six Feet Under* and *Curb Your Enthusiasm*, and original movies *61** and *Wit*. But for the 49-year-old executive who started his career as an operations manager for a California vineyard, the highlight of the year was sitting on a windswept Utah Beach in northern France on June 6. Bewkes huddled with 47 surviving members of Easy Com-

pany, a group of elite riflemen who were last together in 1944 when they parachuted behind enemy lines on D Day. HBO built theater on the beach to debut its 10-part mini-series *Band of Brothers* that chronicles the unit. "It was such an emotional day," says Bewkes.

The fact that the \$125 million project produced for the small screen by Hollywood heavyweights Tom Hanks and Steven Spielberg says something about Bewkes' ability to draw talent to his pay TV network. "He reinvented HBO, from being about just running feature films to creating some of the coolest programs on TV in a generation," says MTV Networks CEO Tom Freston.

And while Bewkes' predecessor Michael Fuchs, who was fired in 1995, ran HBO as more of a top-down operation, Bewkes is

KEY ACCOMPLISHMENTS

■ Revenues in 2001 should grow by 10%, to \$2.5 billion, and operating profits by 30%, to \$700 million

■ HBO received 94 prime-time Emmy nominations in 2001 and won 16 awards

"bottom-up manager who's liberated the creative forces," says Freston, whose MTV is a co-owner with HBO of the cable channel Comedy Central. Indeed, more than 40% of HBO's programming today is original compared with 25% five years ago. "We have consistently create the quality that makes our customers want to pay for the service," says Bewkes. The main reason customers say they sign up for HBO is for the original shows, then for the movies, and then for boxing matches.

The square-jawed executive is frequently mentioned as the one unit chief at AOL Time Warner who is likely to ascend into the executive ranks of the parent company. "That wouldn't surprise me at all," says News Corp. President Peter Chernin. "Jeff's created an incredible profit machine while raising the ante on the network's creative profile. That says something." While HBO accounts for less than 7% of AOL Time Warner Inc.'s revenues, the network is among the media giant's top brands—and brightest success stories. HBO now includes six HBO and four Cinemax channels. Subscriptions have increased nearly 30%, to 38 million, since Bewkes took over in 1995. Operating profits have tripled. And that's how Bewkes got to be Mr. Big.

Charles Lee Ivan Seidenberg

VERIZON COMMUNICATIONS

One of the truisms of Corporate America is that two chief executives in the corner office is one too many. Maybe somebody told Charles Lee and Ivan Seidenberg, co-CEOs of Verizon Communications. In June, 2000, Lee's GTE Corp. and Seidenberg's Bell Atlantic Corp. combined to form the largest local telephone company in the country. They billed the deal as a merger of equals and agreed to share the CEO job. That should have been the cue for power plays, betrayal, and backbiting, right? In fact, power—and board seats—are split down the middle. And while more than a dozen telecom upstarts have gone bankrupt and the long-distance players have seen their stocks plunge, Verizon has cranked out steady results. It could earn \$8 billion



in 2001 on revenues of \$66 billion, up 4%. Meantime, Verizon's stock held its ground through late December vs. a 16% decline for the Standard & Poor's Telecom Index.

It helps that Lee, 61, and Seidenberg, 55, have known each other for 10 years. It also helps that they are only sharing the CEO job until June, when Lee will step down. Most important, Lee says, they trust each other. "Anybody who says it can't be done: Wrong," says Lee. "Anybody who says it's easy: Also wrong." He should know.

KEY ACCOMPLISHMENTS

- Oversaw the smooth integration of Bell Atlantic and GTE
- Increased revenues 4% in 2001, while rivals crashed and burned

Jeffrey C. Barbakow

TENET HEALTHCARE

One of Jeffrey C. Barbakow's prized possessions is an altered photo of the *Star Trek* crew, in which he appears as Captain Kirk. Barbakow, who's been chief executive of Tenet Healthcare Corp. for eight years, received the photo in October on a visit to the Tenet-owned Hollywood Medical Center in Hollywood, Fla. The gift was given in good fun, but the image of the 57-year-old former investment banker as a valiant captain isn't that far off. Since Barbakow took the helm in 1993, Tenet has blossomed from a struggling chain of 35 hospitals into the nation's second-largest operator, with 116 hospitals in 17 states. It posted revenues of \$12 billion in its

fiscal year ended in May and profits of \$643 million—up 113% from 2000.

Barbakow's prescription for success is to acquire hospitals only in markets where Tenet can be one of the largest players. Size gives it the power to continually wrestle higher reimbursement rates from tight-fisted insurers. The soft-spoken Barbakow demands the utmost in efficiency. He even adjusts hospital chiefs' pay based on their ability to collect bills on time. In the past year, Tenet's days outstanding on accounts receivable dropped by 15 days, to 65.

Barbakow once thought of selling Tenet, but now believes the opportunities in health care are too good to abandon. "More than 83 million baby boomers are about to come through the health-care system," he says. The man hailed by employees as the captain of the Starship Enterprise is working hard to rocket Tenet to a healthy future.

KEY ACCOMPLISHMENTS

- Tenet's chain of seven Pennsylvania hospitals turned profitable
- Stock price jumped 35% through late December, while Standard & Poor's Health Care index fell 9.5%

MANAGERS TO WATCH

2·0·0·2

John Creighton

■ UAL



Creighton, 69, is in the race of his career. His predecessor, James Goodwin, cut the payroll and flight schedule at UAL's United Airlines Inc. Now, the new CEO must wring wage cuts from United's unions before the airline runs out of money. At the rate it is burning cash, that could be midyear.

Terry Semel

■ YAHOO!

Seven months after Semel, 58, took the top job at Yahoo, he's just



starting to restructure management while trying to reignite ad revenues. The first positive sign: an 86% jump in holiday-sales volume. But that alone may not be enough to win over advertisers and investors.

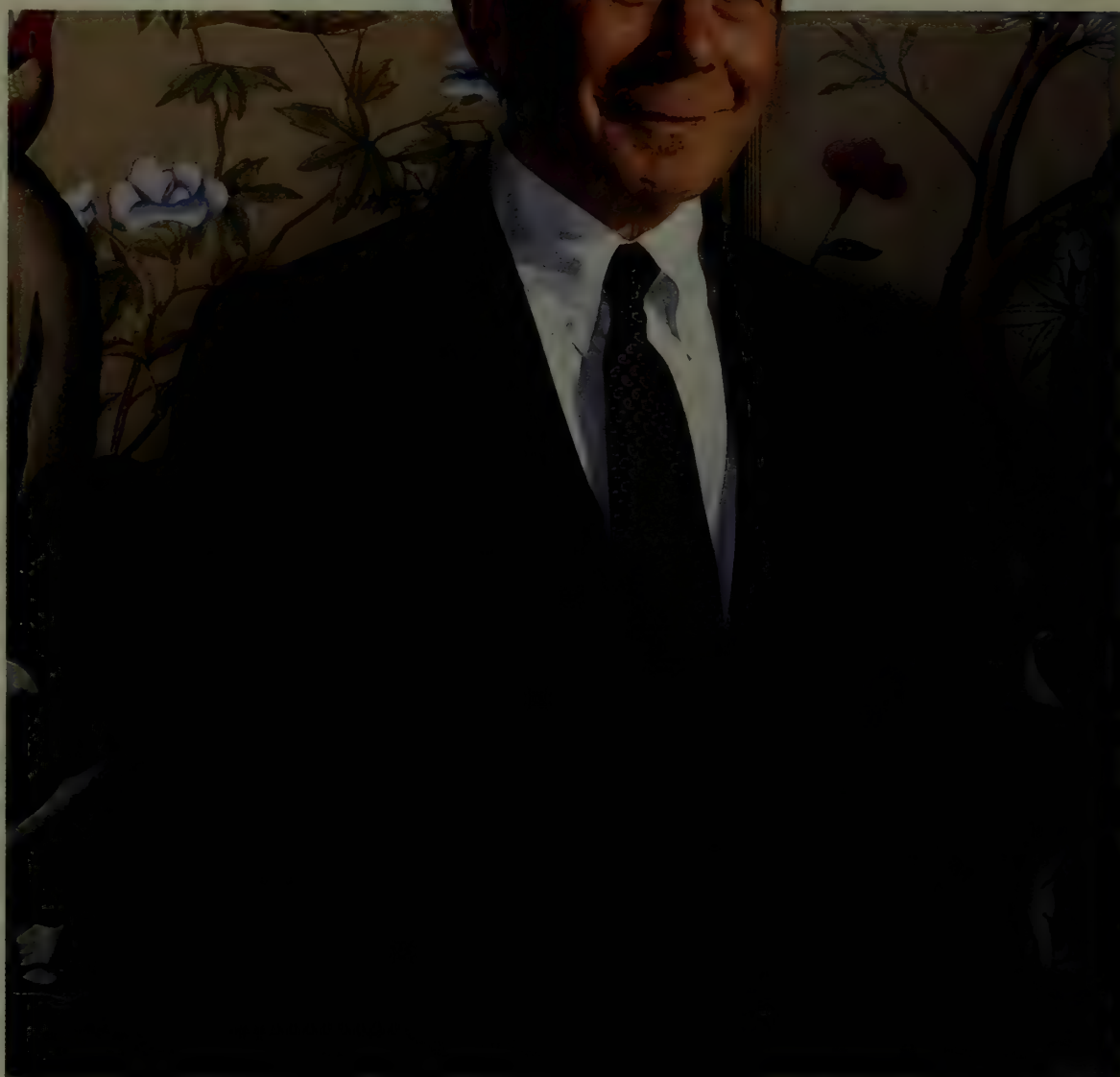
Stephen Bollenbach

■ HILTON



With fewer people traveling, hotels are hurting. And Hilton is already heavily in debt, thanks to an expansion binge. Still, Bollenbach, 59, has refused to slash capital spending and is using the slowdown to renovate older hotels. But if travel doesn't bounce back soon, Hilton could suffer.

THE TOP ²⁵ MANAGERS



Maurice R. Greenberg

■ AMERICAN INTERNATIONAL GROUP

He's not the type to give group hugs. But few run their business better than Maurice R. Greenberg of American International Group Inc. The colorful, sometimes bombastic chairman and chief executive managed to push the insurance giant to a profit of \$327 million in the third quarter, despite an \$820 million hit from

the September 11 attacks and charges relating to its recent \$23 billion acquisition of American General Corp. Even so, analysts are predicting 15% earnings growth for 2001. AIG's diversity and global reach certainly help, but Greenberg also runs a rigorous operation with margins that rank among

the highest in the industry. "That discipline constantly paid off," says shareholder John Waterman of Rittenhouse Financial Services.

Greenberg, 76, came to the industry by accident, knocking on the door of Continental Casualty Co. three days after he returned from serving in Korea. In vintage Greenberg style, he chewed out the boss of a man who initially rebuffed him and wound up with the job. He later moved to AIG, and in 1967 succeeded Cornelius Vander Starr, who founded the company in 1919 as a small Shanghai-based insurer. Under Greenberg, it has expanded into everything from asset management to aircraft leasing, with more than \$300 billion in assets. He has also championed innovative products that insure almost any type of risk, including Internet identity

theft and hijacking. Says Greenberg: "When new ideas come in, they don't find a deaf ear."

In many ways, it has been a difficult year for the insurance chief. The September 11 attacks led to the largest payout in AIG history, as well as the deaths of several people he knew. And both of the sons he groomed as heirs apparent—Evan and Jeff—now work at other companies. Each cited personal reasons for leaving the family fold. That's O.K. though, as the famously workaholic Greenberg has no intentions of retiring anytime soon. "I still have lots of plans," he says. "It's up to the board to decide." No doubt they'll decide to let Greenberg run the show awhile longer.

KEY ACCOMPLISHMENTS

- Launched innovative products to cover risks such as online identity theft and hijacking
- Increased heft in life insurance, wealth management, and retirement planning with the acquisition of American General Corp.

Steven A. Ballmer

MICROSOFT

With \$15 billion to his name, Microsoft Corp. CEO Steven A. Ballmer need never work again. But after 21 years collaborating with Chairman William H. Gates III to build the company into a global power, Ballmer has no desire to leave. A man who once needed throat surgery because he yelled so much, he is as enthusiastic as ever. "Let's just start with the fact that I love to work," he says.

In his second year as CEO, Ballmer, 45, has managed to fortify Microsoft's position as an industry leader. In June, 2000, a federal judge ordered Microsoft broken in

two as punishment for violating federal antitrust laws. But the company has negotiated a proposed settlement that leaves intact its ability to add features to the Windows monopoly. The fine states are su-



ing for harsher restrictions.) Now, Microsoft is one of the few stars in techdom: Its sales in fiscal 2001 grew 10%, to \$25.3 billion, although profits fell 28%, to \$7.3 billion, largely from a charge related to dot-com and telecom investments.

KEY ACCOMPLISHMENTS

- Launched new multibillion-dollar products such as Windows XP and the Xbox game console

- Settled federal antitrust lawsuit without making concessions that would restrict future Windows development

Microsoft is taking market share away from such rivals as Oracle Corp. in database software and Sun Microsystems Inc. in computer-server software. That's a big reason Ballmer keeps going to the office every day.

company had earnings growth of 7.6%, compared with losses at its major competitors.

Mark avoids media interviews—the last thing he wants is too much personal attention—but he's happy to play the devoted CEO for his employees. Last summer he was spotted cheering for the Colgate softball team in New York's Riverside Park. Born in blue-collar Jersey City, N.J., Mark attended Vermont's Middlebury College and later earned an MBA from Harvard Business School. Today he lives in upscale Greenwich, Conn. In the past, he and his wife Arlene have spent many Saturdays tutoring kids in Manhattan as part of the "I Have a Dream" Foundation. At his urging, Colgate has gotten involved: It financed the rebuilding of a school in Harlem. There are not many CEOs who make the time for community volunteer work. And even fewer who don't want to talk about it when they do.

KEY ACCOMPLISHMENTS

- Colgate generated \$3.6 billion in sales from new products in 2000

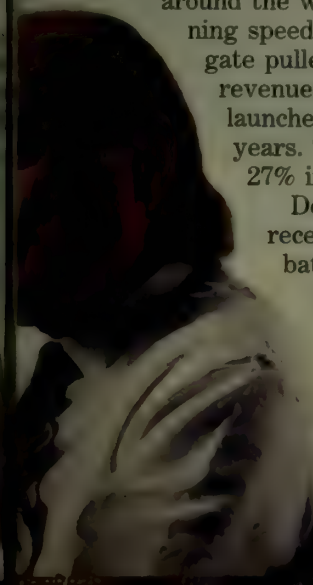
- Total return to shareholders of 3,363% during his 17-year tenure is more than triple that of the S&P 500

Reuben Mark

COLGATE-PALMOLIVE

In a year of high-profile CEO dismissals, it's remarkable that the same man has been running Colgate-Palmolive Co. since 1984. Experience working through previous slumps may have helped Reuben Mark, 62, keep the company on track. So is his relentless focus on developing new products and getting them to markets around the world with lightning speed. In 2000, Colgate pulled 38% of its revenues from goods launched in the past five years. That's up from 27% in 1996.

Despite a global recession that has battered rivals like Procter & Gamble and Gillette Co., Colgate continues to outperform. In the September quarter, the



MANAGERS TO WATCH

2·0·0·2

Patricia Russo

■ KODAK



Can Russo, 49, revive troubled Kodak? The star executive was hired away from Lucent Technologies Inc. in April to become president, behind Chairman and CEO Dan Carp. Her first big move to boost profits was a November restructuring. The payoff, if there is one, should come this year.

Jeffrey Bezos

■ AMAZON.COM

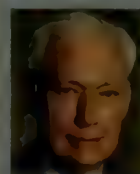
Against all odds, Bezos, 37, has kept Amazon.com off the dot-com junk



heap through savvy deals, a focus on customer service, and cost-cutting. Holiday sales may have been stronger than expected, but Bezos still has to do much more to satisfy increasingly impatient creditors and investors.

James Kilts

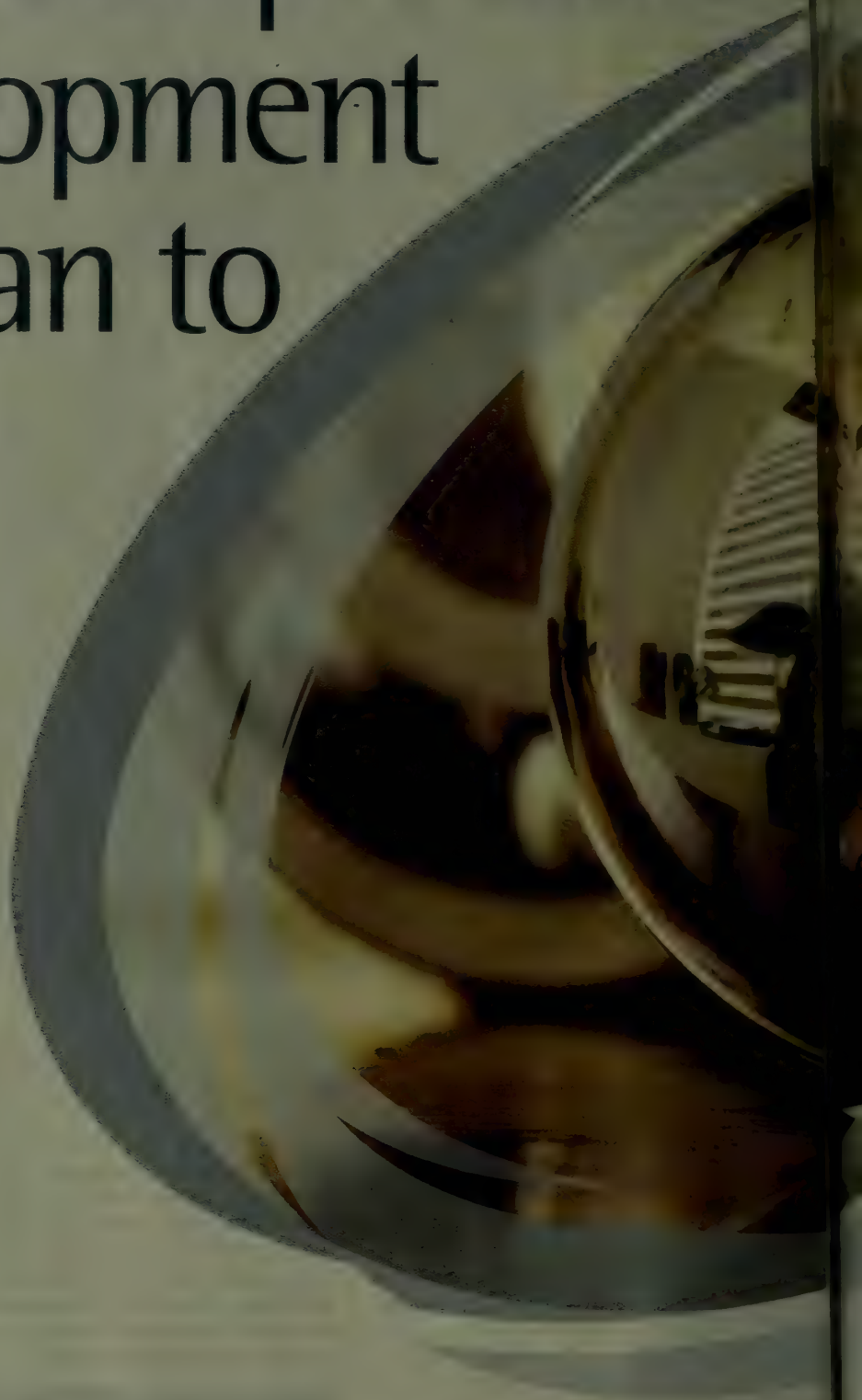
■ GILLETTE



The first outsider to head Gillette in seven decades, Kilts em-

barked on a comprehensive turnaround—beefing up marketing, cutting costs, and shaking up management. But the earnings slide has continued. Kilts, 53, said it would take time. This year, he'll have to deliver.

What does product development mean to you?





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THE TOP MANAGERS

25

Steven S Reinemund

■ PEPSICO

The Friday after the September 11 terrorist attacks, Steven S Reinemund gathered employees at PepsiCo Inc.

headquarters in Purchase,

N. Y. President Bush

had asked for a mo-

ment of silence at

noon; at Pepsi,

that moment

turned into a

one-hour multi-

faith prayer

meeting.

Reinemund,

53, himself a

devout Presby-

terian, is ex-

hibiting more of

his softer side

since taking over

the company's top

job on May 2. But

there are plenty of

hard numbers to

back up his spot on

the list as a top manager. Based on a strong first three quarters, Morgan Stanley Dean Witter & Co. analyst William Pecoriello expects worldwide profits for company's Frito-Lay Co. unit to increase 11% this year, and total beverage sales to rise 12.6%. That comes as the company expands operating margins in both businesses. Pecoriello expects Pepsi's total 2001 income to be \$2.98 billion, on sales of \$26.99 billion.

A fierce competitor who made his mark at Frito-Lay by increasing its U.S. market share to 57% in 1999, from 39% in 1991, Reinemund is certainly not focusing on employees' well-being solely for humanitarian reasons. Keeping his people happy is the key to Pepsi's future success, Reinemund says. "To have growth in products

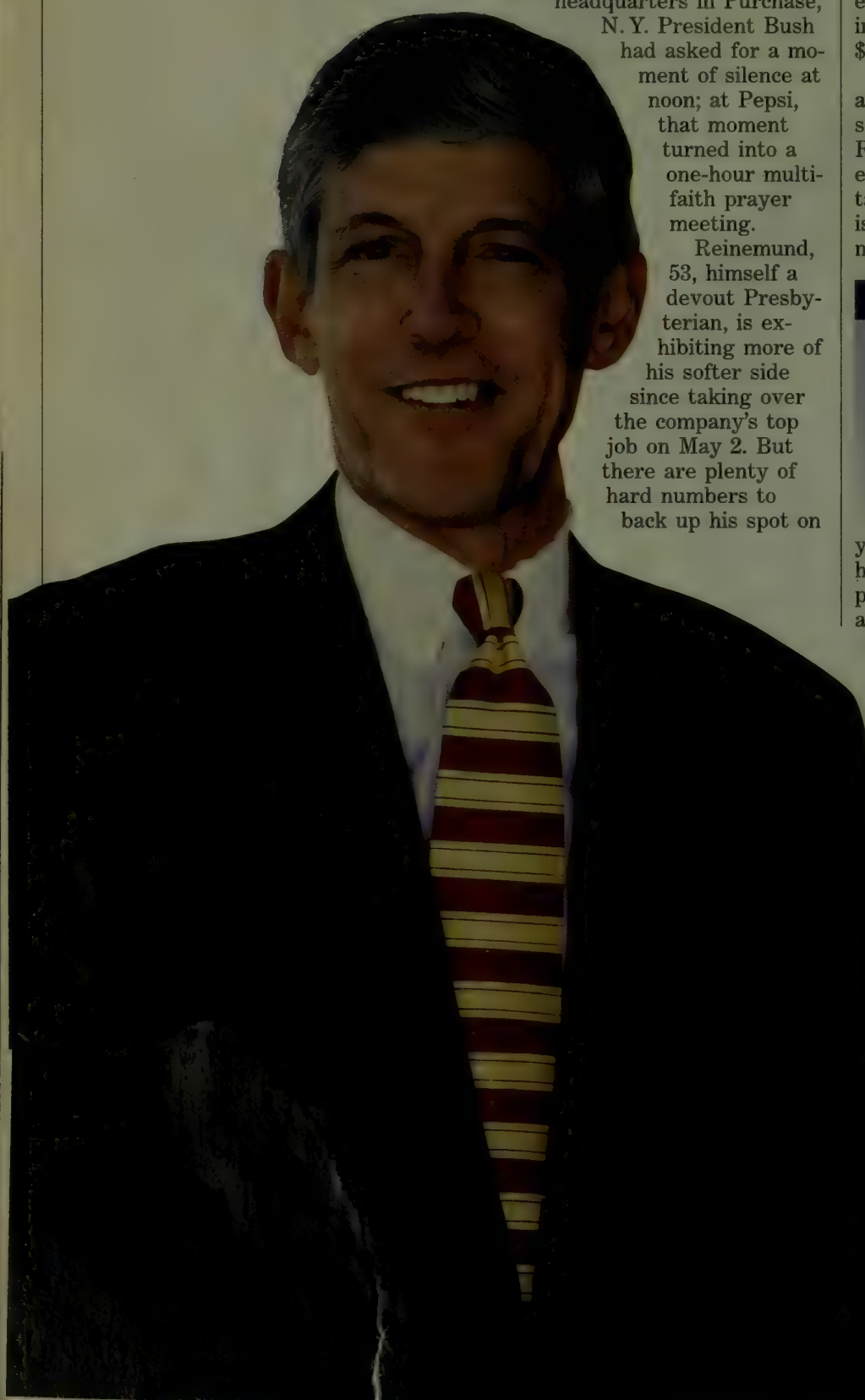
KEY ACCOMPLISHMENTS

■ Closed the \$14 billion acquisition of Quaker Oats Co. despite opposition from some on the Federal Trade Commission

■ Sales grew an estimated 7% in 2001; earnings increased an estimated 14%

you have to have growth in your people," he says. That means giving employees opportunities to move from one business to another, and also diversifying his workforce. Reinemund now insists that 50% of all new employees be female or minority; promotions and departures are monitored as well.

Reinemund, a marathon runner, has put a three-year growth plan in place. In August, he paid \$14 billion for Quaker Oats Co., which owns the \$3 billion sports-drink brand Gatorade. Reinemund contends that he'll see \$400 million in annual cost savings from the deal by 2005. Now, he has to make sure a combined Quaker and Pepsi can grow faster than each would have alone. Wall Street likes his numbers: Since Reinemund's promotion was announced in October, 2000, Pepsi's stock is up 10%, compared with a 14% fall for Coca-Cola Co.



Margaret C. Whitman

EBAY

When Meg Whitman joined eBay Inc. in May, 1998, from Hasbro Inc.'s Preschool Div., her lack of technology experience left many doubting that she could run an Internet company. And when the auction site took off during the dot-com boom, some people wondered if she just got lucky. Not anymore. After almost four years at the helm, Whitman, 45, can take credit for transforming the onetime Web flea market into a global marketplace for everything from \$1 compact discs to \$5 million jets.

Not only that, she's surpassed expectations during a war-worsened recession. In the third quarter of 2001, eBay beat forecasts with a 71% jump in sales, to \$194.4 billion, and profits

of \$18 million. The value of merchandise sold through the site last year: a staggering \$13 billion.

Affable and self-effacing, Whitman is quick to attribute



eBay's success to its 38 million customers, who play a huge role in suggesting new features and categories: "Having millions of buyers and sellers who can make adjustments far faster than any company could is a huge advantage for us." Whitman herself has bought a car and sold the entire contents of a Colorado vacation home on eBay.

Whitman opened new opportunities by moving into fixed-price sales and new countries. At some point, the recession could curb growth, but for now, it's hard to find doubters.

KEY ACCOMPLISHMENTS

- Expanded international business from 7% of sales in 2000 to 14% in 2001
- Pushed to sell items at fixed prices, which now account for 16% of sales

Craig A. Conway

PEOPLESOFT

When Craig A. Conway took over the corner office at software maker PeopleSoft Inc. in September, 1999, he found a company headed for trouble. Revenues were flat. Profits barely existed. And employees were leaving in droves—the attrition rate hit 26% at one point—for the lure of dot-com riches.

Conway couldn't even get executive headhunters to work with him. "The implication was," says Conway, "they didn't feel good about recruiting to losers."

They're happy to take his calls now. Thanks to Conway's risky bets, PeopleSoft, which specializes in software that runs big business systems, is a rarity in

the industry—it did not disappoint Wall Street in 2001. Its third-quarter revenues were \$509.4 million, up 15% from a year ago. Profits doubled to \$50 million. And through early December, execs sent signals that the fourth quarter was on track.

Three moves are paying off. First, Conway, 47, doubled spending on research and development so PeopleSoft could get an all-Internet version of its software out by late 2000. In January, 2000, he paid \$495 million for Vantive Corp., putting him smack in the middle of the hot market for customer-management software. And he brought much-needed discipline to an outfit that hadn't even bothered to press delinquent customers for payments.

Conway wants the Pleasanton, Calif., company to grow from its \$2 billion annual revenues to \$5 billion by 2005. That will take a lot more than a great turnaround strategy.

KEY ACCOMPLISHMENTS

- Software license revenues are expected to grow about 30% in 2001, to more than \$620 million
- Profits should jump more than 25% for the year, to about \$180 million



MANAGERS TO WATCH

2·0·0·2

Ann Mulcahy

■ XEROX



Mulcahy, 49, appointed CEO in August, is popular with staff. But after five quarters of operating losses, Xerox still

needs to convince Wall Street it can thrive again. She slashed expenses, sold assets, and promised to post profits in 2002. Xerox' reputation may be harder to resurrect.

Jean-Marie Messier

■ VIVENDI UNIVERSAL

Messier, 45, knows it will be a while before Web-enabled cell phones and



interactive TV sets carry entertainment to the masses. That's why the chairman and CEO has struck deals with USA Networks, EchoStar, and others to broaden distribution of Vivendi's entertainment offerings.

Charles Ergen

■ ECHOSTAR

A onetime professional poker player, Ergen, 48, outdueled Rupert Murdoch to win satellite giant DirecTV. The deal is



still under tough antitrust scrutiny. If he succeeds, Ergen will face cable outfits that want to up the ante with interactive TV and Net services that are hard to offer via satellite.

THE TOP MANAGERS

25



Hiroyuki Yoshino

■ HONDA MOTOR

Hiroyuki Yoshino doesn't mind being called a stargazer. As a boy, a favorite pastime was staring at the nighttime skies and dreaming of charting the heavens. Now the president and CEO of Japan's second-largest carmaker, Yoshino, 62, is still marveling at the constellations—and setting sky-high goals. The trained aeronautical engineer wants to boost Honda Motor Co.'s annual

sales in Japan to 1 million units, up from the roughly 850,000 cars it sold in 2001.

Honda has gone alone without a strategic partner and has quickly seized beachheads in the hottest and most profitable segments of the auto industry: sport utilities, minivans, and,

in Japan, subcompacts. Investors have been rewarded, too. Honda's market capitalization of nearly \$39 billion is now bigger than that of the beleaguered Ford Motor, though it trails industry kingpins DaimlerChrysler and Toyota. Still, that's not bad for a company with annual sales of \$54 billion, about one-third those of Ford and DaimlerChrysler.

Honda's success is due in part to its superior manufacturing techniques. Thanks to "smart" robots and shared vehicle parts, Honda factories can swiftly adjust just output among different models of the same line to meet shifting demand. They can ratchet up output for example, if the MDX sport utility for example, if the Odyssey minivan sales taper off.

For now, though, Honda can barely keep up with orders for both—despite

Yoshino's refusal to offer 0% financing, a tactic Ford and General Motors have. In November, sales rose 12% compared with the same period a year earlier—almost double the 7.5% industry average. Yoshino is also well acquainted with the U.S. market, which accounts for two-thirds of Honda's operating profit. He spent four years as president of Honda's U.S. subsidiary in Marysville, Ohio, a decade ago when trade tensions were high, and handled the assignment with aplomb.

But Yoshino's most impressive accomplishment is Honda's stellar performance in Japan, where sales have risen for the past 24 consecutive months amid a domestic auto sales slump. Now, if Yoshino can fix rusty spots such as Europe, his star will shine even brighter.

KEY ACCOMPLISHMENTS

■ U.S. sales in 2001 should surpass all-time high of 1.1 million vehicles the previous year

■ Displaced Nissan to become Japan's No. 2 carmaker

L. Lee Scott Jr.

WAL-MART STORES

Thanks to a recession, war, and tight-fisted consumers, 2001 will hardly go down as a barn burner for giant Wal-Mart Stores Inc. Earnings are likely to show a meager 6% on a 13% revenue gain, about \$218 billion. But everything's relative. Many retail rivals are facing steep declines. And CEO H. Lee Scott Jr. is taking advantage of their misery by turning up the heat with sharper pricing, tighter cost controls, and better execution in his stores. Scott has helped to perfect these strategies in past downturns. He's raising capital spending by nearly \$1 billion, to \$10 billion in 2002, while many others are being forced to pull back. Under Scott, 52, Wal-Mart's price discount and food-and-merchandise "supercenter" businesses appear to be thriving. And the international unit is posting vastly improved results. Even Wal-Mart's Club, the



warehouse-clubs that were once company stepchildren, are seeing robust gains.

Scott, the son of a Kansas gas station owner, spends at least one day a week visiting stores. When same-store sales rose less than 4% in May, Scott sounded the alarm. Analysts say the company has improved operations since. "The real key is taking care

of customers," says Scott. And as Wal-Mart's shares have amply demonstrated over the years, if customers aren't disappointed, shareholders won't be, either.

KEY ACCOMPLISHMENTS

- In a lousy retail environment, revenues grew about 13%, to \$218 billion
- Low cost structure and focus on grocery sales are boosting market share

John D. Wren

OMNICOM

Like many owners of established marketing companies, Roger E. Winter, CEO of the Promotion Network Inc., had his pick of suitors. So why did he throw his lot in with advertising giant Omnicom Group a month ago? Winter says the allure was simple: "They don't meddle."

Sound like a backhanded compliment? Not to John D. Wren, Omnicom's 49-year-old president and CEO. Since taking over in January, 1997, Wren's game plan has been to build a deep bench of ad agencies, promotional shops, public-relations firms, direct marketers, and branding consultants. He imposes tight financial controls, then lets them pursue their bliss.

What he doesn't do: try to convince Omnicom clients to hire sibling units for their other needs.

So far, his plan has worked like a charm. In a sagging ad market, Omnicom's revenues and income both rose 8% in the third quarter, as acquisitions and new-business wins offset client spending declines. Even analysts who tempered their fourth-quarter expectations are still looking for a gain over 2000. Wren's financial discipline paid off during the dot-com bubble. He laid down the law in early 1999: agencies could pursue dot-commers' business as long as they did not lease extra office space to serve it. The result: no big real estate and severance charges, as at some rivals lately. "We want to be in a leadership position," Wren says, "but we'll do it in a prudent way." Who can argue with that these days?

KEY ACCOMPLISHMENTS

- A range of marketing activities and new-business wins kept Omnicom growing, despite the ad-spending slump
- His hands-off approach to flagship agencies has helped them keep their creative focus

MANAGERS TO WATCH

2002

Stan O'Neal

■ MERRILL LYNCH



O'Neal, Merrill's president, has terminated troubled overseas ventures and will cut payroll, possibly by as much as 15%. If he can't remake Merrill into a more profitable giant, the firm could be bought. If he succeeds, O'Neal, 50, will take over from Chairman and CEO David H. Komansky.

John Eyler

■ TOYS 'R' US



In a brutal retailing environment, CEO Eyler, 54, is laboring to turn the toy giant around. This is the year his remodeled stores and new Times Square showplace need to post strong results. If they don't, they'll go down as ill-advised extravaganzas.

Brian Roberts

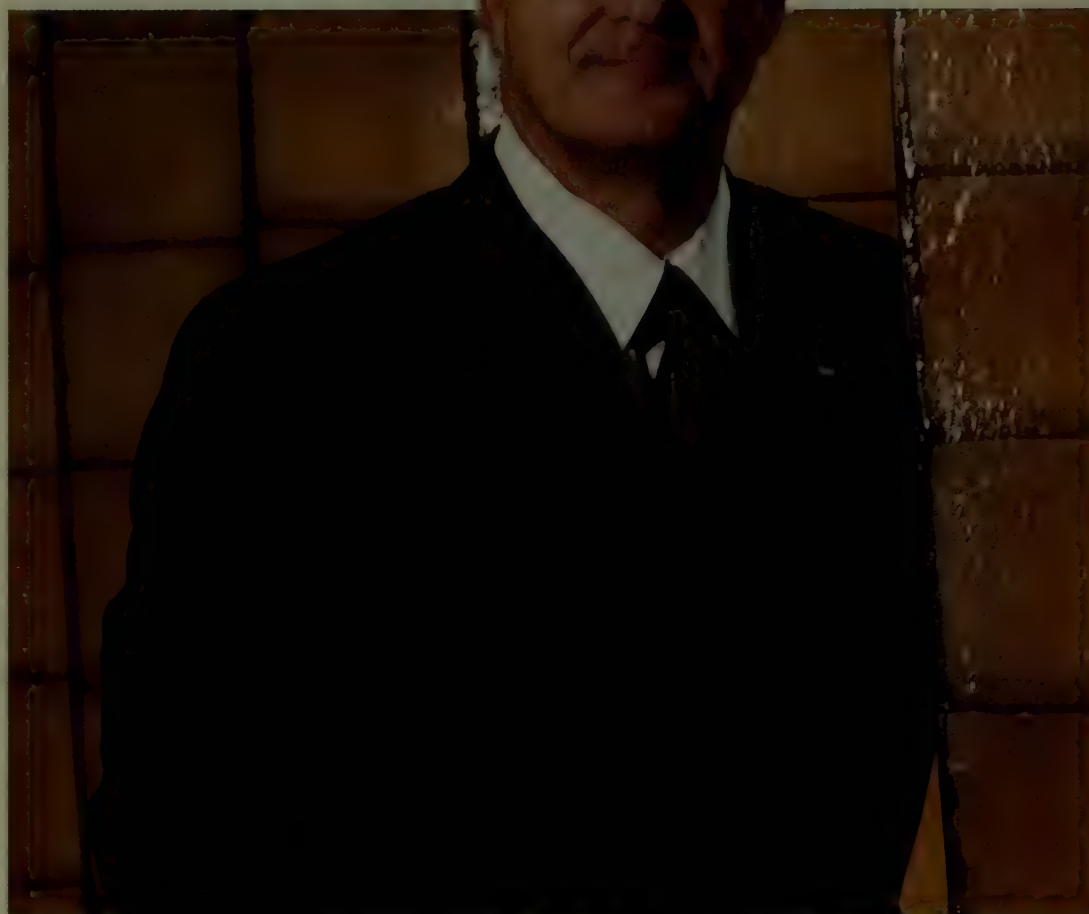
■ COMCAST



In December, CEO Roberts, 42, won a months-long bidding war for AT&T's cable assets. The \$47 billion deal will make the Philadelphia-based company the largest cable operator in the U.S. That gives Roberts the leverage to buy more content and turn Comcast into a full-blown media empire.

THE TOP MANAGERS

25



Richard B. Priory

■ DUKE ENERGY

Richard B. Priory may be soft-spoken, but he thrives on competition. A talented baseball player, Priory won a tryout with the New York Mets after high school—but lost the last farm team slot to future star Ron Swoboda. Priory refused to hang up his cleats, though, and despite a series of broken bones, he played fast-pitch softball well into his 40s for a Charlotte (N.C.) team known as the Pac-Men.

As chief executive of Duke Energy Corp., the 55-year-old Priory has used a Pac-Man strategy to transform the company from a regional electric utility into an integrated energy provider. In his four years at the helm, Priory has been on an acquisition tear—swinging more than 80 deals—to gain control of everything from gas reserves to pipelines to power plants. Duke's pieces fit together well: Even as energy prices wane, it continues to generate ever-higher profits from its vast operations. Net income was on track to rise 37%, to \$2.15 billion, in 2001, on top of a 17% jump the year before. "It has been a fun ride," he says with a smile.

Not that any of this was easy. After tak-

ing over in 1997, Priory set out to overhaul Duke's bureaucratic culture. Eventually, he replaced one-third of the top executives with more entrepreneurial outsiders. And while Priory's 1997 acquisition of a natural gas provider was at first ridiculed on Wall Street, it gave the ex-college professor the power source to begin producing and reselling energy to smaller utilities in states that had deregulated. Duke now generates 95% of its revenues from unregulated transactions. "He's willing to take bigger and bolder steps than other utility executives," says Kit Konolige, an analyst at Morgan Stanley Dean Witter & Co. At the same time, Priory has carefully hedged most of Duke's activities in these new markets—an approach that's helped insulate Duke from the post-Enron fallout that's hit the rest of the industry. That's why Duke's flame is burning bright.

KEY ACCOMPLISHMENTS

■ Net income should increase 37% in 2001, to \$2.15 billion, on operating revenues of \$68.4 billion

■ The \$8.5 billion purchase of Westcoast Energy lets Duke accelerate construction of new power plants in the Western U.S.

MANAGERS TO WATCH

2·0·0·2

Joseph Galli

■ NEWELL RUBBERMAID



After some high-profile job-hopping, Galli became CEO of troubled Newell Rubbermaid. He has cut jobs, hired a new sales force, and launched new products. Galli, 43, claims he's "gaining traction," but it's too early to say if he's right—or if he'll stick around long enough to find out.

David O'Reilly

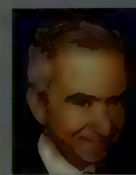
■ CHEVRON TEXACO



After paying \$35 billion to buy Texaco, O'Reilly, 54, now has to deliver \$1.8 billion in promised savings. The chief of the No. 4 oil company may make a large natural-gas acquisition, and he intends to exploit projects such as oil fields in Kazakhstan and West Africa.

Bernard Arnault

■ LVMH



Arnault, 52, has added dozens of brands to the world's biggest luxury group over the past five years. Problem is, most of the new stuff is losing money. To get back on track, he has to unload companies such as cosmetics retailer Sephora and pump more into purchases like Donna Karan.

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THE Top ENTREPRENEUR

From a nuclear engineer who's transmitting electricity across the U.S. to a shipping heir offering no-frills European flights...

Frederick W. Buckman

■ TRANS-ELECT

Frederick W. Buckman, a lifelong teetotaler, collects wine. He tastes it and spits out every sip. That self-discipline will be useful as Buckman embarks on another contradictory venture: trying to mine entrepreneurial profits from the highly regulated, slow-growth business of electricity transmission. The 55-year-old nuclear engineering PhD is chairman, CEO,

and co-founder of privately held Trans-Elect Inc., a two-year-old company that in 2001 led deals worth \$850 million to buy transmission grids in Alberta and Michigan. Co-investors include the likes of General Electric Capital Corp. Buckman's goal: to become one of the biggest transmission owners in the U.S.

Regulators favor companies that carry power without generating it because there are fewer conflicts of interest. Buckman hopes they'll let him post a 14% return on equity—about three percentage points above what integrated utilities earn. Although Trans-Elect is in Washington, D.C., Buckman still lives in Portland, Ore., where he was CEO of Pacificorp until 1998. When he's not striking deals or swishing wine, he likes to golf. His handicap is 2.

Stelios Haji-Ioannou

■ EASYGROUP

Stelios Haji-Ioannou, 34, the chairman and founder of easyGroup, based in London, has a very specific goal: to open one new company a year under the Easy brand. So far, he's on schedule. In the past six years, Haji-Ioannou has launched six businesses, from online car-rental and financial-services sites to cyber cafés. The son of a Greek-Cypriot shipping magnate, Haji-Ioannou is building a discount empire.

His crown jewel is easyJet Airline Co., a European no-frills carrier. While national airlines are grounding planes, six-year-old easyJet recently purchased new Boeing 747-300 jets and is on track to make \$54 million on sales of \$519 million in 2001. In a November share placement, easyJet raised \$137 million.

Haji-Ioannou's penchant for self-promotion has led to comparisons with Richard Branson, head of Virgin Group Ltd. He has even shown up on rival airlines

Special Report

NEURS

Joseph J. Atick

VISIONICS

On Sept. 10, Joseph J. Atick was just another scientist laboring in relative obscurity. A day later, he was the hottest thing in high-tech security. His seven-year-old company, Visionics Corp. of Jersey City, N.J., makes biometrics software that uses facial measurements matched against those in a database to identify anyone from terrorists to runaways captured on video. That has politicians, retailers, and immigration officials knocking down his door. Atick, who invented the technology, suggests using the system only in high-risk areas and discarding images when no match is

made to maintain privacy. "We need to identify those individuals who pose a threat to public safety, while maintaining the anonymity of you and me," says Atick, 37.

A former physicist, Atick is riding a wave that will only get bigger. The \$200-million biometrics market is expected to hit \$1 billion by 2004. And since Sept. 10, Visionics' stock price has nearly quadrupled, to about \$15. Atick may be surprised by his sudden fame, but the nation's newest apostle of high-tech security knows his loss of anonymity is the price of admission.



passed in easyJet's trademark orange flight suits. But Haji-Ioannou wants to spin off his ventures into publicly traded, independent companies. "My intention is to make money out of capital gains, not royalties," says. And, unlike Branson, Haji-Ioannou comes from wealth: His personal fortune is estimated to be \$1.3 billion, and he also owns a shipping company. When Haji-Ioannou isn't working, he's off sailing. "I have a couple of yachts," he says. "Every self-respecting Greek shipowner has." His business is serving budget-minded customers, but Haji-Ioannou travels in style.

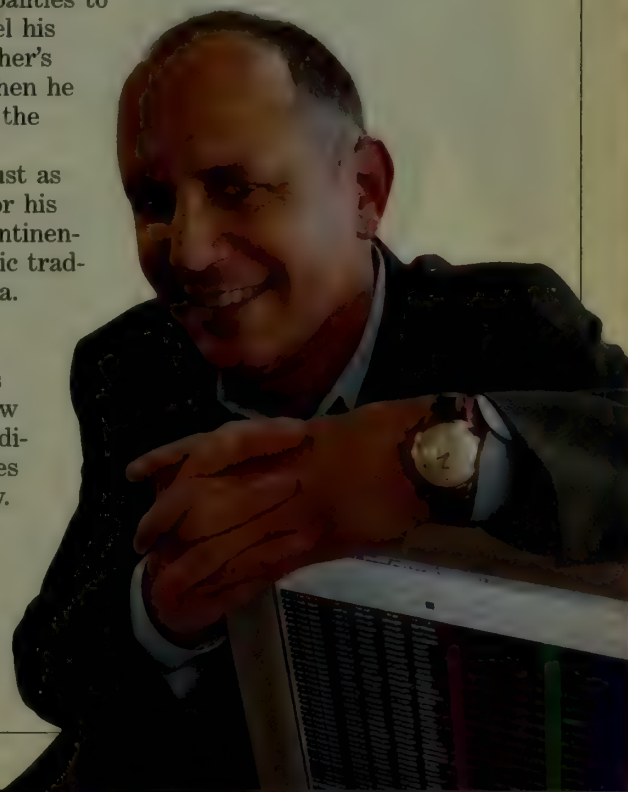


Jeffrey Sprecher

■ INTERCONTINENTAL EXCHANGE

Jeffrey Sprecher made his first fortune building alternative power plants in California in the late 1970s. First, he got investors to agree to financing if he could drum up business. With that commitment in hand, Sprecher persuaded utilities to buy his power and municipalities to give him raw materials to fuel his trash-to-energy plants. Sprecher's out-of-pocket costs? Nada. When he sold the small-scale plants in the mid-1990s, he made millions.

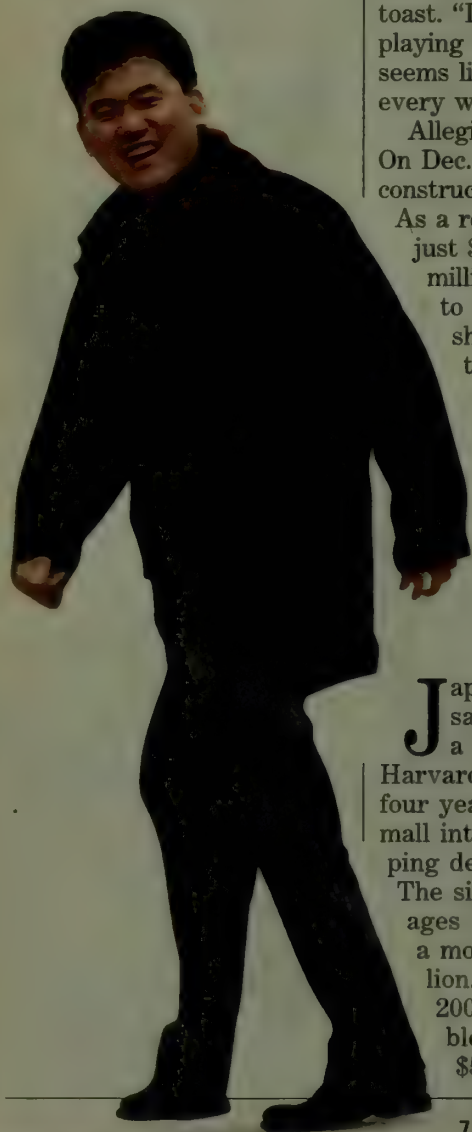
Sprecher, 46, has proved just as adept at creating a market for his one-year-old venture, IntercontinentalExchange Inc., an electronic trading exchange based in Atlanta. He gave energy and trading firms equity stakes if they pledged to trade commodities over his system. Sprecher now handles \$2.5 billion in commodity trading daily, with revenues of about \$120 million annually. Enron Corp.'s bankruptcy is helping. "This is one B-to-B exchange that's generating profits and cash—and using Internet technology correctly," he says. At least someone is.



...to a physicist's timely facial-recognition software and an alternative-energy whiz's B-to-B energy exchange

THE **Top** ENTREPRENEURS

Big payoffs for a telecom founder who played it safe, a music mogul who didn't, and a Japanese cyber-shopping visionary



Royce Holland

■ ALLEGIANCE TELECOM

Royce Holland was an oddity among the telecom entrepreneurs who founded companies in the late 1990s to compete with such giants as Verizon, SBC, and AT&T. While his rivals took on mountains of debt, the chief executive of Allegiance Telecom played it safe, borrowing little and expanding slowly. And he raised a huge amount of equity: \$1.4 billion in three stock offerings. Then, last year, the shakeout began. The stock market dried up, followed by the debt market. Without access to more capital, upstarts with huge interest payments and unprofitable businesses were toast. "It's a lot like playing *Survivor*," says Holland, 53. "It seems like somebody is voted off the island every week."

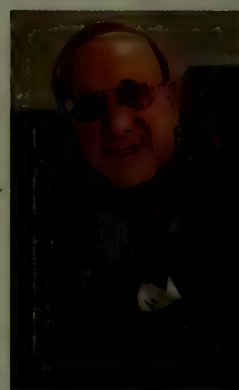
Allegiance, however, is still in the game. On Dec. 3, the Dallas company completed construction of local networks in 36 markets. As a result, its capital spending could be just \$225 million in 2002, down from \$365 million in 2001. With revenues expected to rise 75%, to \$975 million, Allegiance should generate net cash from operations, before interest payments and depreciation, in the second half. It looks like Holland could win this round of *Survivor*.



Hiroshi Mikitani

■ RAKUTEN

Japan and e-commerce? Forget it, said the critics. But Hiroshi Mikitani, a 36-year-old former banker with a Harvard MBA, has proved them wrong. In four years, he has built his Rakuten cybermall into the country's most popular shopping destination for Japanese Web users. The site, home to 8,000 retailers, averages 18 million daily visits and handles a monthly turnover of about \$64 million. Rakuten's operating profit in 2001 is expected to more than double, to \$16 million, on sales of some \$53 million, which is also up more



Clive Davis

■ J RECORDS

In 2000, the then 67-year-old music impresario Clive Davis could have retired when his boss decided to replace him at the helm of Aris-

Records, the label he founded in 1974. Arista's parent, BMG Entertainment, wanted someone younger, so they brought in Antonio "L.A." Reid, 44, to take over from Davis. Undaunted, Davis launched J Records. "I had to start from scratch and prove it again," says Davis. Well, sort of. Davis persuaded BMG to kick in \$150 million to become a 50-50 partner in J and let him have 85% of Arista's management as well as 10 artists. And he still got his reputation. As Doug Morris, CEO of Universal Music Group, says: "In this business, he's the guy."

In 18 months, Davis has filled J's roster with some of the most promising acts in the business, including Alicia Keys, whose debut album *Songs in A Minor* has sold 6 million copies and who is nominated for four American Music Awards, which will be presented in January. J should book \$200 million in sales in 2001 and could turn a profit next year. But for Davis, who signed such talent as Janis Joplin, Bruce Springsteen, and Santana (twice), it's still all about the music. A recent Manhattan performance by singer Angie Stone, Davis—in trademark tinted glasses—was among those swaying to the music. He still has his groove.

than twofold from the previous year.

Since taking Rakuten public last year, Mikitani has bought 10 companies, including Bizseek, a popular used-goods trading Web site, and the Japanese operations of U.S. portal Infoseek. His policy is to write off the goodwill on the acquisitions in the first year, which in 2001 will translate into an extraordinary net loss of \$5.3 million. So far he has managed to turn around the money-losing Infoseek Japan by cutting advertising and operational costs and introducing new services. He hopes to increase the total goods and services his cybermall handles tenfold, to nearly \$8 billion annually by 2005. As Mikitani puts it: "Japanese have learned that the Internet is a more efficient way to find a good deal." Now, he has to hope they keep shopping.

FINANCIAL CAPACITY

[ANOTHER REASON PSEG HAS WALL STREET'S ATTENTION]

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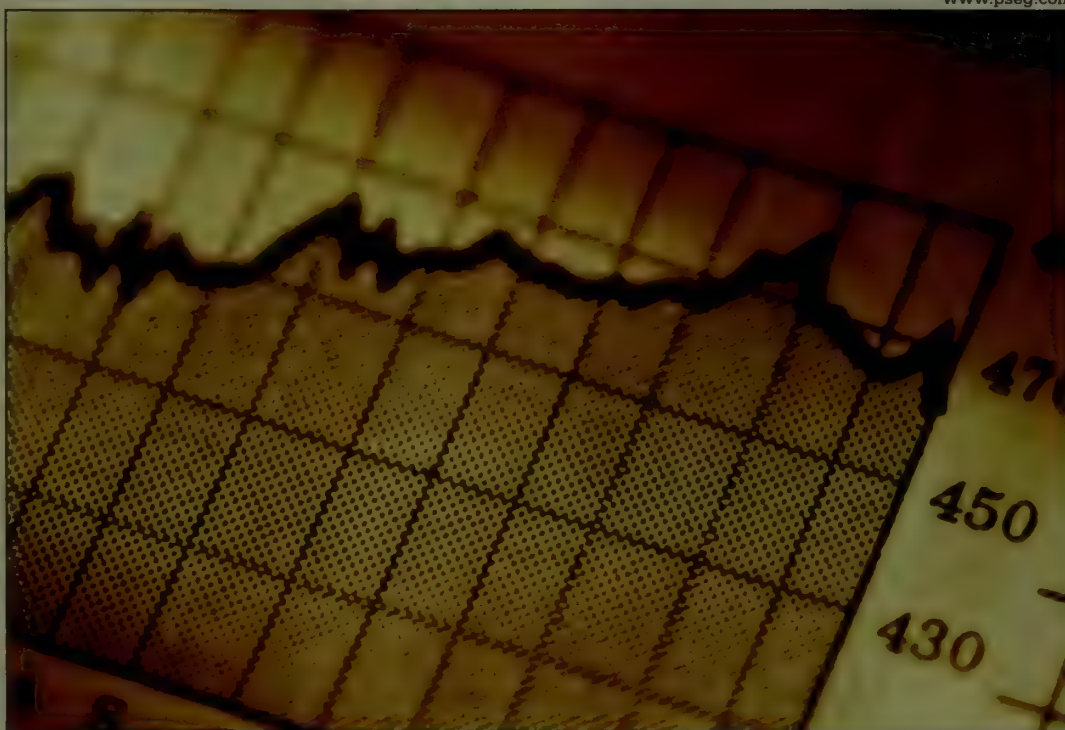
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THE Fallen

While their shareholders lost a bundle, these humbled honchos now find themselves on the outside looking in

Special Report

Jacques A. Nasser

■ FORMERLY OF FORD

Just two years ago, Jacques A. Nasser was riding high. As Ford Motor Co.'s chief executive, he was acclaimed as a bold manager poised to remake Ford's corporate culture into a lean and quickly changing meritocracy. Fast-forward to Oct. 29: Nasser is shown the door.

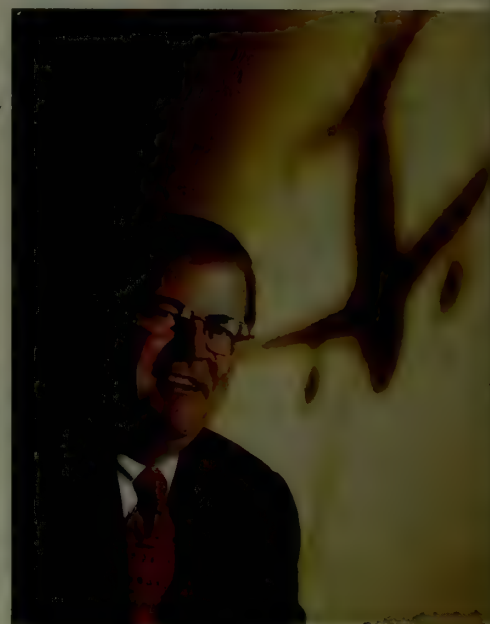
The trouble started in August, 2000, with the first of two recalls of Firestone tires used on Ford's popular Explorer sport-utility vehicle; the total cost came to \$3.5 billion. In

2001, the e-commerce ventures that Nasser had begun tanked. In the marketplace, Ford was ceding its long dominance of the lucrative truck market to archrival General Motors Corp. Ford's auto operations lost \$1.6 billion in the first nine months of the year, and its stock price tumbled 28%, to \$17.35. Inside Ford, morale plummeted. Draconian new performance reviews sapped spirits and spawned lawsuits. But Nasser's biggest misstep may have been to try to cut Chairman William C. Ford Jr.—great-grandson of the founder—out of the loop on decision-making.

Since he was axed, Nasser, 54, has kept to himself in Detroit but has told a friend he plans to visit Australia, where he grew up. Details of his severance aren't available.

But Ford sweetened Nasser's exit package a month before he was fired. In addition to an annual pension of nearly \$1 million and performance compensation through 2003, he

will get full payment on restricted stock granted to him in 2001. It isn't known how many shares he received, but his 2000 award is now worth \$5.8 million.



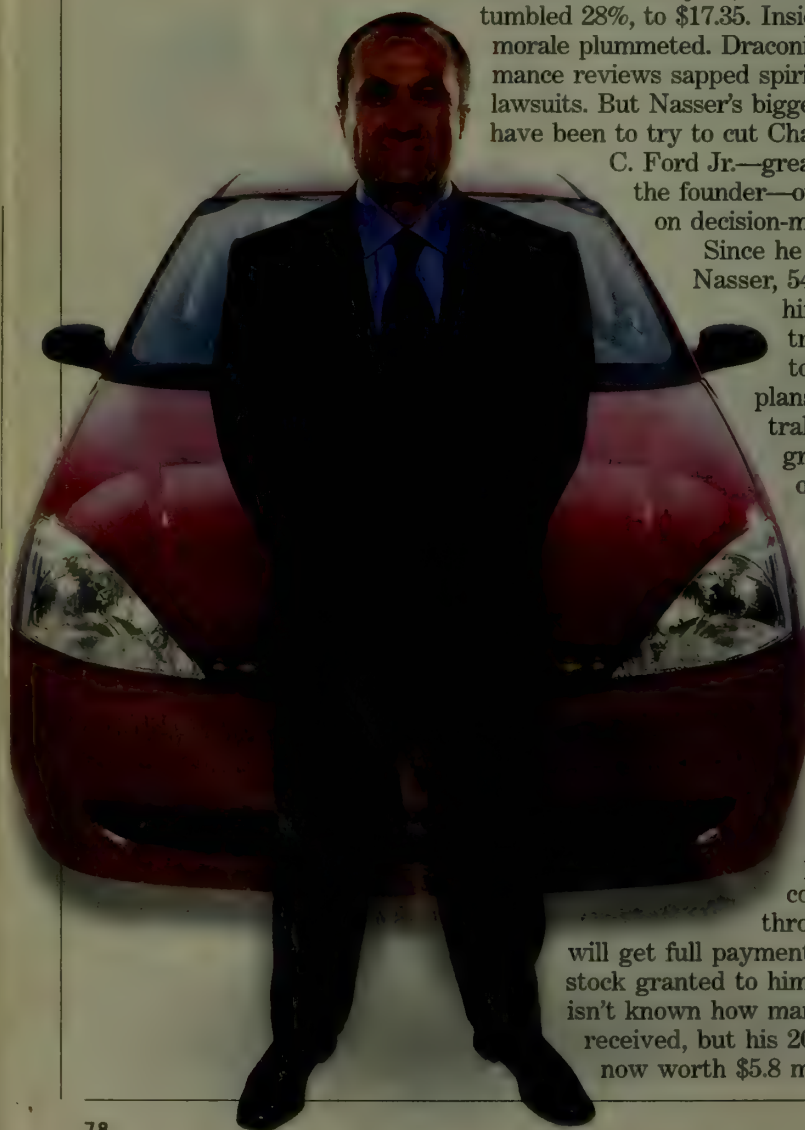
James E. Goodwin

■ FORMERLY OF UAL

James E. Goodwin wrote himself out of a job on Oct. 18. The chairman and chief executive of United Airlines parent told employees in a letter that the airline was hemorrhaging money. "Clearly, this bleeding has to be stopped—and soon—United will perish sometime next year," Goodwin warned. The letter, which came after Goodwin had already cut 20% of the carrier's flights and fired 20,000 workers, enraged United's union leaders. They reacted as a clumsy first step toward coercing pay cuts and demanded Goodwin's ouster.

Worse for Goodwin, the letter also highlighted for the entire board the financial mess he had made even before two United planes were hijacked on September 11. In August, 2000, he approved huge wage hikes for pilots—intended to curry support for takeover of US Airways Group—which almost overnight turned UAL into a money loser. Nor did he have a backup plan after the Justice Dept. nixed the takeover of US Airways last July.

Today, Goodwin, 57, walks with a new spring to his step, say those who know him. And why not? While CEO John W. Creigh Jr. now must tussle with United's unions, the unemployed Goodwin is guaranteed a salary of at least \$900,000 a year through mid-2004 under his UAL contract. Goodwin may have left the building, but he continues to haunt the company.



Jeffrey K. Skilling

FORMERLY OF ENRON

When Jeffrey K. Skilling abruptly left Enron Corp. in August after six months as CEO, he was brimming with plans for the future. First up: spending time with his children and charity work. Now, with the world's largest energy trader in bankruptcy, Skilling may need to fend off lawsuits and answer to regulators instead. As one of the masterminds of the financial maneuvering that led to Enron's downfall, Skilling, 48, is key in a controversy that wiped out more than \$60 billion in shareholder value. He continues to insist that he resigned for "personal reasons" and not because of looming troubles at Enron. A daredevil by nature, Skilling once took customers on such jaunts as a 1,000-mile



dirt-bike trip through Mexico. Yet insiders say he was fanatical about imposing risk controls on Enron's trading operation. Now many wonder why those controls did not apply to its aggressive finance group. The normally verbose Skilling, who left without a severance package but sold millions in stock, is still trying to explain that.

WE NEITHER
ADMIT NOR
DENY...

For many CEOs, it was a year of reckoning, as they found themselves on the losing end of some major legal challenges. Here are several of the most notable—and expensive:

Jack Welch

■ COST: \$500 MILLION

General Electric Co. was ordered by the Environmental Protection Agency to pay for the cleanup of toxic chemicals in the Hudson River, an outcome former CEO Welch had fought for decades.

The Pritzker Family

■ SETTLEMENT: \$460 MILLION

The Pritzkers arranged to pay the Federal Deposit Insurance Corp. to avoid protracted litigation over the failure of Superior Bank FSB of Chicago.

Maurice Myers

■ SETTLEMENT: \$457 MILLION

Waste Management Inc. settled an investor class action. This was the second such settlement and covered those who bought the company's stock between June, 1998, and November, 1999.

Miles D. White

■ SETTLEMENT: \$437 MILLION

Abbott Laboratories' TAP Pharmaceutical Products Inc. settled criminal charges of conspiracy in a Medicaid overbilling scheme. Abbott's partner, Takeda Chemical Industries Ltd., paid another \$437 million.

Joseph Berardino

■ SETTLEMENT: \$110 MILLION

Arthur Andersen LLP, now ensnared in the Enron Corp. fiasco, resolved shareholder suits charging it had failed to properly audit the books of Sunbeam Products Inc.

Lloyd D. Ward

■ U.S. OLYMPIC COMMITTEE

Is the third time the charm? Lloyd D. Ward hopes so. Having lost his first two jobs as chief executive, Ward, 52, is now getting a third chance to prove his mettle as CEO of the U.S. Olympic Committee.



That's quite a coup, considering his recent record. In November, 2000, after 15 months at the helm of Maytag Corp., the board demanded he resign as profits plunged. He then joined iMotors, a Web site selling used cars; it shut down in May after burning through \$140 million.

Now he has to restore morale at an organization troubled by a bidding scandal and athletes' drug use, while wooing donations in a down economy and ensuring security at the Salt Lake City games. And, as the USOC's fourth CEO in two years, he needs to show he's not just there to burnish his reputation and move on. "Anything I get into, I'm into 100%," Ward says. Plenty of Olympic athletes and fans are hoping that's enough.

Deborah C. Hopkins

FORMERLY
OF LUCENT



A year ago, Deborah C. Hopkins barely had time to breathe over the holidays as chief financial officer of troubled Lucent Technologies Inc. This year, she made children's angel wings for her church pageant. Since her dismissal in May, Hopkins, 47, has also learned to golf and works out with a trainer four times a week. This is the hard-charging star dubbed "Hurricane Debby"? Hopkins says a lot has changed since she left the telecom equipment maker barely a year after arriving from Boeing Co. The Lucent saga and September 11 changed her priorities. She values time with her family and refuses to leave for a job. She is doing some consulting, and headhunters think she could be a go. But Hopkins isn't yet sure if she wants another high-profile, mega-stress position. She claims to be more patient and much happier now. As for her critics: "They had better look out," a newly buff Hopkins laughs, "because I'm getting very strong."

INDUSTRY

A recovery is likely, but one with a small "r." Even with productivity up and interest rates at historic lows, anemic demand will make patience a virtue for company and investor alike

As economists and corporate executives assess the prospects for a U.S. recovery this year, they are starting to sound like President Clinton testifying in front of a grand jury. "It depends on what you mean by recovery," observes Maury Harris, chief economist at UBS Warburg. "If you mean a complete recovery to 2000 levels of growth, that's not going to happen."

That said, there's little doubt the U.S. economy will rebound from the recession in the next 12 months—at least to the extent that it hits bottom and starts growing before the second quarter ends. The combination of deep interest-rate cuts by the Federal Reserve and last year's tax-rate reductions should have the intended effect of warding off a precipitous downturn, even if the Republicans and Democrats can't manage to agree on a fiscal stimulus package.

As recoveries go, however, this one won't be very impressive. The growth rate measured from the fourth quarter of 2001 to the fourth quarter of 2002, will be about 2%, according to West Chester (Pa.)-based Economy.com Inc. Moreover, things could get still worse before they get better. "I think the economic recovery is likely to be later in the year," says Thomas W. Horton, CFO at American Airlines.

**MANUFACTURING**

Orders for airliners are falling, as are oil prices; no big lift for builders; and in autos, a hangover from 0% financing

85

**INFORMATION**

Slow growth for business software, no boost for PC makers, a slump in ads, and telecom is mired in overcapacity

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**FINANCE**

Insurers will hike premiums in the first half of September 1 and brokerage is moving cautiously

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OUTLOOK 2002

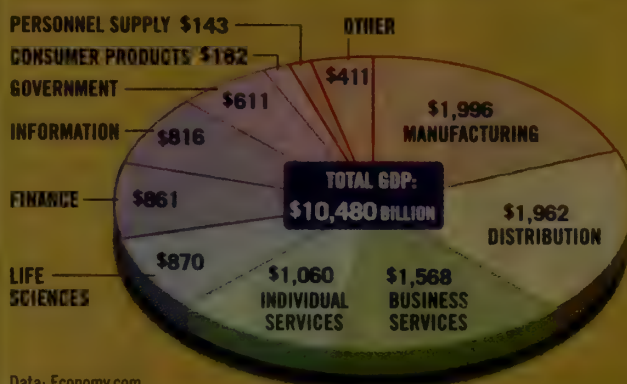
"The strength of that recovery is anybody's guess." The uncertainty is because the situation now is more complicated than at the end of the last downturn. For starters, although the tech sector should stop hemorrhaging, it's unlikely that businesses will buy a lot more computer equipment or software until the fourth quarter at the earliest. Hard-pressed managers expect to continue to hold down capital budgets—along with inventories, wages, and other reducible expenses—as they cut costs and try to boost productivity.

Increased efficiency is surely a plus, but the push to get leaner could have a nasty side effect. There will be precious little job growth even after the economy starts to recover. Indeed, unemployment could continue to climb as companies push fewer workers to do more. Sustained unemployment means that consumer spending—which has held up through the start of the recession surprisingly well—will start to sag. And the looming recession abroad will keep foreign buyers from taking up the slack. "The soft landing everyone was predicting a year ago has been anything but," says John Perriss, CEO of media buying firm Smith Optimedia Group.

Still, rising productivity, together with tight controls on labor costs, could lift profits of companies in Standard & Poor's 500-stock index by 10% from the fourth

NOT MUCH TO GROW ON

The slower-growing Old Economy still accounts for the biggest slice of GDP
CONTRIBUTION TO GDP, 2002 ESTIMATE (IN BILLIONS)



LIFE SCIENCES

One big pain for Big Pharma will be expiring drug patents; a new farm bill could brighten the day for agribusiness

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For shippers, logistics is the hot spot; upscale restaurants will struggle; and discount retailers will flourish

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Dire predictions for consulting and travel businesses—but for-profit educational services should do well

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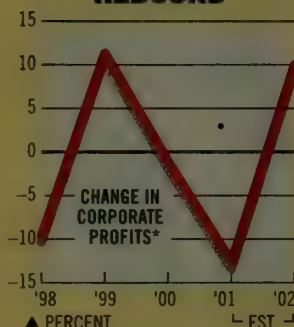
THE OUTLOOK BY THE NUMBERS

Data courtesy of Economy.com

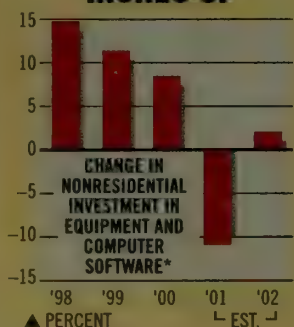
A MODEST RECOVERY



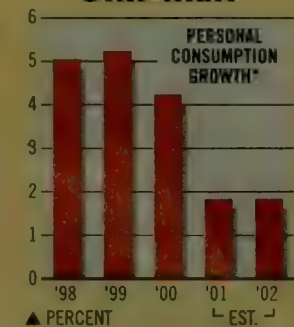
PROFITS REBOUND



INVESTMENT INCHES UP



CONSUMERS STAY WARY



*FOURTH QUARTER TO FOURTH QUARTER
Data: Economy.com

quarter of 2001 to the fourth quarter of 2002, according to Economy.com. Some forecasters are more optimistic. "There will be a significant earnings turn in the fourth quarter," insists Bruce Steinberg, chief economist at Merrill Lynch & Co. He expects a 30% surge in S&P 500 profits in the same period.

After squeezing costs out of the supply chain, food companies such as Campbell Soup, Kellogg, and ConAgra

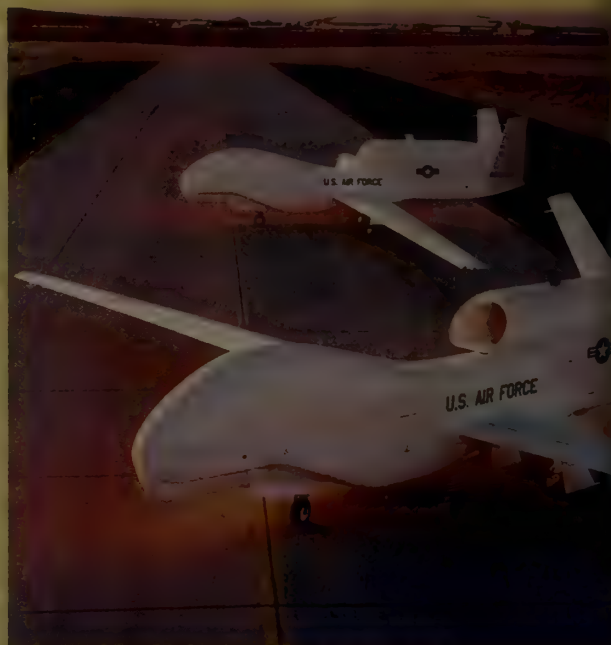
expect to see earnings growth of 8% to 10%. And drug companies will still turn a profit, helped by a raft of new products. "In the last three years we've doubled the productivity of R&D," says Eli Lilly & Co. chairman and CEO Sidney Taurel.

Productivity gains aren't the only plus. Banks will continue to benefit from low interest rates that reduce their borrowing costs and improve lending margins. In the wake of September 11, insurers plan to raise their premiums aggressively, and the defense and security sectors will mushroom as the "War on Terrorism" develops. Among retailers, discounters will continue to excel. Wal-Mart Stores Inc. CEO H. Lee Scott Jr. plans to increase his capital spending by 11%, to \$10 billion, and to hire 75,000 employees in 2002.

Low interest rates will also keep the construction sector buoyant, even though there won't be a big uptick in building. "When the Fed cuts interest rates, the hope is that the economy will get an upsurge in building," says Lynn Michaelis, chief economist for the building materials and pulp and paper giant, Weyerhaeuser Co. In the last recession, for example, single-family housing starts fell sharply and then rebounded when the recovery began, giving the economy a big lift. This time, housing starts aren't declining much, so there probably won't be a big rebound. "The residential sector will be neutral at best, and it could be a slight drag," says Michaelis.

Capital intensive industries, on the other hand, will struggle. "As near as anybody can forecast, in the first half, companies will still be reducing spending," warns J. Thomas Madden, Federated Investors Inc.'s chief investment officer. Manufacturers, for example, which are operating at 72% of capacity, have neither a strong reason nor the capital to spend on new machines. It's a similar story for tech buyers, who seem more interested in getting their existing mix of computers and software working right than in adding more. "Info-tech people are saying, 'We've had this

DRONES: More money is being slated for high-tech weaponry



LEADERS

PHARMACEUTICALS New blockbusters could rack up billions in sales, despite political pressure on drug

INSURANCE Skyrocketing premiums will help insure and restore assets decimated by the September 11 disaster

SEMICONDUCTORS After the worst downturn ever, a bounceback in chip sales could surprise skeptics

DEFENSE Commercial jetliner sales will be down, but the war on terrorism will buoy weapons spending

drunken technology spree, we need to sober up," says Vernon Turner, an analyst at International Data Corp. "They're starting to become uncomfortable over buying more infrastructure than they need."

As a result, tech equipment and software sales may drop at an annual rate of 5% to 10% through June, projects Neal Soss, chief economist at Credit Suisse First Boston. "We're seeing little bright lights in certain areas, but not enough to say we have comforted a significant improvement [for tech spending]," says Michael Winkler, executive vice-president of Compaq Computer Corp.

The drought in business spending has hit the travel industry, too. Construction starts for additional hotel rooms will drop to 33,200, from their peak of 158,000 in 1998, according to data from PricewaterhouseCoopers, as lodging companies try to come to grips with lower demand. And airlines, which cut 20% of their capacity following September 11, may permanently retire upwards of 6% of these seats. "The high-end business traffic is not where it needs to be," says Gordon M. Bethune, CEO of Continental Airlines Inc.

Media will suffer as well, because advertisers will continue to stick with austere bu



LAGGARDS

ACTIVE Detroit's 0% financing lifted 2001 sales, profits—and dragged down prospects for this year

Fear of terrorism will keep airplane seats empty, in vacant hotel rooms and fewer car rentals

M As businesses cut spending on communications, expectations for a recovery grow faint

Even with a government bailout, import protection, consolidation, steelmakers will be in dire straits

Ad spending fell 4% in the U.S. in 2001, 1.7% worldwide—the first global drop since World War II. For 2002, ad-giant Universal McCann is projecting a modest 2.2% increase, to \$466 billion, most of it coming in the second half.

The outlook isn't much rosier for consumer-products companies. Having shown remarkable staying power throughout the downturn of 2001, consumers may finally have been knocked out in the fourth quarter. The Commerce Dept.'s Dec. 3 report on aggregate personal after-tax income showed that it fell by 2.4% in October. That number will continue to deteriorate as unemployment climbs to as high as 6% or 7% by midyear.

Already there is evidence that rising unemployment is dampening overall wage gains. In the third quarter of last year, the wage and benefits component of the employment cost index had slowed from 1.1% growth in July to 0.5% growth in September. As unemployment keeps higher, wage gains will slow further.

It's not just weak incomes, however, that will hurt consumer spending. Part of the problem is that low interest rates convinced many consumers to accelerate big purchases ahead of 2002. That's true in the auto industry, where aggressive financing and promotions induced so many car buyers to purchase ahead of schedule that 2002 sales could drop by more than 10%, to as little as 14.8 million units. That spells trouble for Detroit's profitability. "None of the North American operations is making money at 16 million units [sold],"

observes Federated's Madden. Unfortunately, U.S. companies can't look abroad to make up for shaky domestic demand. In the 1990s the U.S. consistently set the pace for the global economy. Most economists—especially those based overseas—expected that Europe and Asia would be the main engines of growth in the coming decade. While that may eventually turn out to be true, the numbers for 2002 won't be worth bragging about.

VACANCY: As business travel dives, so does hotel demand

Indeed, world growth is expected to crawl along at 1.1% this year. Europe's economy is still in slow motion, and—once again—Japan's will be in reverse. What's worse, there's no sign yet of a non-U.S. productivity pickup that would produce a global New Economy-style boom. In Europe, for example, the latest data show productivity growth averaging a resounding 0%.

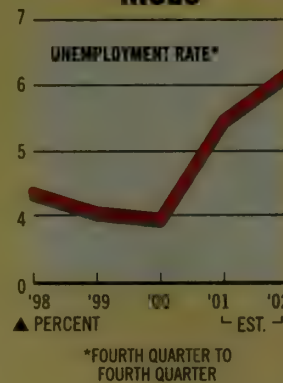
So, with all this bad news, why expect a recovery at all? In part because many companies have already chopped inventories so much that even the slightest blip up in demand will require some spending to meet it. And that will benefit even hard-hit industries such as steel. "Many of our customers have shrunk down their safety stocks [of steel]," says Robert S. "Steve" Miller Jr., chairman and CEO of No. 3 U.S. steelmaker, Bethlehem Steel Corp. "I am cautiously optimistic about this."

Moreover, consumers are still benefiting from low interest rates, falling energy costs, and the income tax cuts passed last June. Taken together, these could mean a 3% boost to personal income, says Bruce Steinberg of Merrill Lynch. That should keep consumer spending afloat even as unemployment rises.

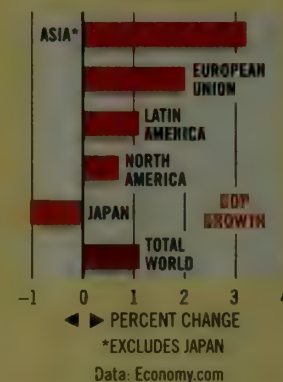
During the boom of the 1990s, companies bet on fast growth and sky-high goals. But this year, patience and moderate expectations are going to turn out to be virtues. The economy is going to grow, but slowly—and that will feel better than the dreariness of 2001.

By Margaret Popper, with Tom Lowry in New York, Michael Arndt and Julie Forster in Chicago, Andrew Park and Wendy Zellner in Dallas, and Amy Barret in Philadelphia

UNEMPLOYMENT RISES



GLOBAL GROWTH 2002



DATA GUIDE

The following charts accompany each industry outlook:

SPOTLIGHT Shows industry performance, 1998-2002

PRODUCTIVITY Gives Economy.com's estimate of value added per worker.

This "value-added" approach avoids counting the same sales twice.

For example, it excludes the wholesale cost of goods sold by retailers.

EMPLOYMENT Total number of workers.

GROWTH PROSPECTS *BusinessWeek* has assigned each industry a grade, summing up the outlook for growth and profits. In addition, there is forecast data for output and output growth, also provided by Economy.com.



You speak to a server *It recognizes you and actually knows how to help.*

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COMMUNICATION WITHOUT BOUNDARIES

LAURA SMITH

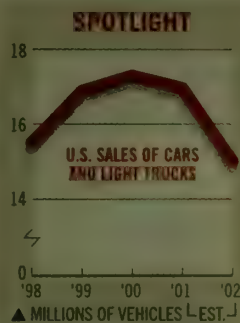
AUTOS 86
CONSTRUCTION 88
AEROSPACE 90
ENERGY 92
**METALS &
MACHINERY 93**

MANUFACTURING

ILLUSTRATIONS BY LAURA SMITH

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PROGNOSIS 2002

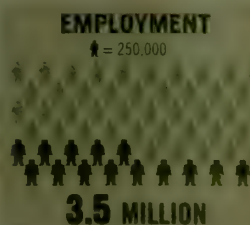
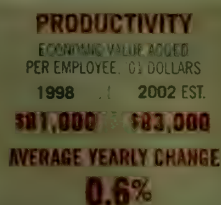


POSITIVES

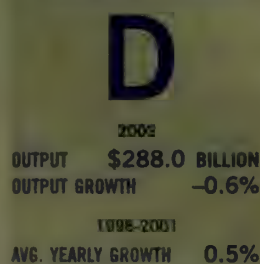
- Sticker prices remain low—it takes about 24 weeks of salary to buy a car, down from 28 in 1995
- Continued low interest rates will make it easy to finance a new car

NEGATIVES

- The blitz of low-interest financing late last year pulled ahead a million or more auto sales from 2002
- Fat margins on trucks and SUVs are vanishing as more players get in the game



GROWTH PROSPECTS



Data: Economy.com

0% FINANCING: A RISKY ADDICTION

Norman Herbert had been planning to trade in his 1992 Pontiac Transport minivan for a new model next spring. "The van was getting shaky, but I would have tried to get it through one more winter," says the Sterling Heights (Mich.) dentist. Then the flood of 0% loans that domestic carmakers unleashed to jump-start sales after September 11 lured him into a showroom months ahead of schedule. In October, Herbert drove home a new 2002 Pontiac Grand Prix GT.

Detroit can thank consumers like Herbert for the fall's rip-roaring sales rate. At the height of the financing frenzy, autos were moving at an annualized pace of 21 million units, breaking a monthly sales record set in 1986. However, the generous incentives are sapping Motown's bottom line, in what Morgan Stanley Dean Witter & Co. analyst Stephen J. Girsky calls "profitless prosperity." Thanks to 0% financing, an estimated 1 million Americans bought sooner than planned, setting up a future sales vacuum. "There's got to be some payback," warns Nick Scheele, Ford Motor Co.'s chief operating officer.

Even by the final weeks of 2001, the hangover from the 0% party was beginning to drag down sales. And most industry watchers expect that queasy feeling to continue well into the new year. "We borrowed from the future, so the first quarter is squat," says Diane C. Swonk, chief economist at Bank One Corp. in Chicago. She predicts that auto sales in the first quarter of 2002 will drop 12% from December levels, to a 14.6-million-vehicle annual pace. Still, Swonk and most economists look for an upswing to begin by midyear. Says Tom Elliott, executive vice-president of American Honda Co.: "We think it'll be off quite a bit in the first half and then recover in the second half."

Ask car execs and auto analysts how strong the summer rebound will be, however, and opinions diverge sharply. Estimates for 2002 U.S. auto sales range from 14.8 million cars and light trucks—which would be the lowest level since 1995—to a robust 16.8 million vehicles. The high end is just

short of the 17 million sold in 2001, the second best year in auto history. Sighs Scheele: "I very hazy outlook."

Certainly, an economic recovery would auto sales rebound. For one thing, interest rates remain low, which matters to people lease or borrow to buy a car. And auto affordability hovers near a 22-year low: Detroit's Comerica Bank figures a new vehicle cost average of 24 weeks of pay. Toss in the economic

response of consumers began to treat buying cars a patriotic act after September 11, and you have the makings of a comeback. "The marketplace defied predictions," says Christopher W. Cedergren of Nexter Inc. in Thousand Oaks, Calif.

Sales could just as easily go the other way. Fewer people

be eager to buy cars or other big-ticket items as the recession really begins to bite. "We're heading downhill," says auto consultant Susan Jacobs of Jacobs & Associates in Rutherford, N.J. "The aftereffects of the declines in employment, consumer confidence, and a sluggish stock market still have to work their way through the system." Her most optimistic forecast for auto sales this year is 15.3 million vehicles, a 10% decline from 2001.

Even if sales rebound to healthy levels, carmakers' profitability will remain in jeopardy. Lately, car companies have had to pile on rebates, cut-rate loans, and sweetened lease



FRENZY: About 1 million buyers bit this fall

FORD, GM, AND ... TOYOTA?

The all-American ranks of the Big Three have already been battered. Once, when Germany's Daimler-Benz took over Chrysler Corp., Now, Detroit is bracing for the possibility that a Japanese auto may burst into the dominant threesome. With a new stable of pickup trucks and SUVs, Toyota has been quickly gaining share, leading speculation it might soon overtake struggling Chrysler as the third-largest carmaker.

The numbers tell the story. Toyota has been growing steadily—share is up two full points since 1997 and stood at 10.1% through November last year. Chrysler maintains a lead—at 13.3%—but the pie has narrowed by almost three points since the merger

als to keep sales strong and factories humming. Incentives from auto manufacturers were eraging upwards of \$2,300 per vehicle by e end of 2001—nearly 25% higher than levels fore September 11, according to CNW Mar-ting/Research in Bandon, Ore.

General Motors Corp. didn't help the profit-ure when it launched 0% loans in late Sep-ber. Ford and DaimlerChrysler followed e lemmings, fearing they'd lose market share they didn't. So much for ending Detroit's diction to incentives. These loan wars only nforced the vicious cycle in which consumers p buying as soon as the deals end, forcing rmakers to jump in with even bigger re-es. "It's a nightmare," says Art Spinella, w's general manager, who predicts that high-rebate levels are here to stay.

Those in the strongest position for 2002 are yers such as Toyota, Honda, and Volkswagen, hich shunned 0% deals or limited their use. ota used them for just a handful of models—the first national incentive we've had in years," ys James E. Press, chief operating officer of ota Motor Sales. "It won't be repeated—it is an extraordinary 9-11 thing."

A few segments remain strong. Sales of ort-utility vehicles and other trucks are like-to keep rolling. And despite early fears that ideast war would crimp U.S. oil supplies, es of these gas-guzzlers have continued un-ated. That's partly because prices at the gas mp—under \$1.15 per gallon recently—hover ar an inflation-adjusted 82-year low, according the American Petroleum Institute.

The rising popularity of SUVs and trucks, eever, brings its own headaches for Detroit. German, Japanese, and Korean competitors l out an ever-growing array of SUVs and ucks, Detroit's fat prof- margins in the sec- ar have grown inner. One sign is e escalation of

er W. Ceder- analyst at nc. in Thou- s, Calif., these ggest that Toyota's ce is not just possi-

aybe even likely. As a group, Asian auto makers are expected to other two points of market share this year—to 32%—as their , particularly Ford and Chrysler, continue to struggle financially. ust nothing out there to stop Japan's momentum," says Cedergren. is definitely on a roll, thanks to its expanding lineup, a reputation y, and solid, if unexciting, design. For families, there's the best- mry, which was redesigned for 2002—to rave reviews. In Febru- atrix, a funky new sport wagon aimed at the youth market, will

rebates it takes to keep truck sales revved up. The average combined incentives from manu- facturers and dealers ran about \$3,500 per truck by late 2001, up some 40% from a year earlier, according to CNW.

Shrinking truck profits were just one of Ford's myriad troubles last year. Sliding mar- ket share, poor quality, and the continuing re- call of Firestone tires used on its Explorer SUV contributed to an estimated \$880 million operating loss for 2001. Ford will unveil a ma- jor restructuring plan in mid-January to try to get back on track. Wall Street is hoping the re- vamp will translate into a modest \$641 million profit this year, according to Thomson Finan- cial/First Call's consensus of analyst forecasts.

GM ended 2001 riding high. It wrested dom- inance in trucks and SUVs from archrival Ford and was expected to rack up a small gain in overall U.S. market share—up 0.1 point, to 28.4%—for the first time in more than a decade. Still, declining volume is expected to trim GM's 2002 profit to \$1.1 billion, vs. an es- timated \$1.8 billion last year, according to First Call. Doing even that well will require hanging on to precious market share. "We are going to focus on share this year," vows Gary Cowger, GM's president of North American Operations.

DaimlerChrysler could also be making head- way in its turnaround. The parent is on track to earn \$1.9 billion in 2002, up from an es- timated \$762 million last year, analysts figure. But that's contingent on the Chrysler unit con- tinuing to cut costs and sell assets after 2001's \$3.9 billion restructuring.

It's a tricky balancing act: slashing costs in order to grow, juggling profitability with re- bates. And it will make 2002 one of the most difficult years carmakers have faced in a decade.

*By Kathleen Kerwin,
with Joann Muller
and David Welch,
in Detroit*



A NEW MATRIX: Toyota's sports wagon is aimed at young buyers

go on sale. Toyota's Lexus division, which already rules the luxury market, will add another midsize SUV, the GX470, to its lineup about a year from now.

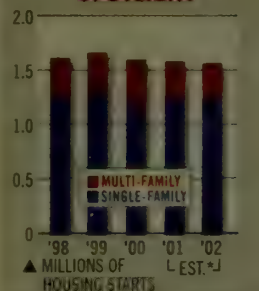
And later this year, Toyota will unveil a third brand that it hopes will attract younger buyers. AutoPacific Group Inc. analyst James Hall thinks Toyota's new products will lead to big market-share gains: "If Toyota doesn't pick up share, something's wrong." Still, Toyota probably won't nab the No.3 spot in 2002 unless Chrysler stumbles badly. But as the 0% financing craze that boosted domestic auto makers last fall peters out, one thing is certain: The momentum in Motown clearly lies with the foreign carmakers.

By Joann Muller in Detroit

"We borrowed from the future, so the first quarter is squat," one economist says of the cheap come-ons. Longer term looks "hazy"

PROGNOSIS 2002

SPOTLIGHT



POSITIVES

- Ultra-low mortgage rates fuel near-record levels of home sales
- Tight supply of some housing types—especially starter homes—mean prices are still rising

NEGATIVES

- The reverse wealth effect is undermining sales of high-end homes
- In the office, industrial, and hotel markets, recession is pulverizing demand

PRODUCTIVITY

ECONOMIC VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 1 2002 EST.

189,000 188,000

AVERAGE YEARLY CHANGE

0%

EMPLOYMENT

↑ = 250,000



9.8 MILLION

GROWTH PROSPECTS

C

2002

OUTPUT \$873.3 BILLION

OUTPUT GROWTH -0.5%

1995-2001

AVG. YEARLY GROWTH 2.1%

Data: Economy.com

EVEN BUILDERS ARE HITTING A WALL

Six miles east of downtown Denver, Forest City Enterprises Inc. is hard at work on the biggest urban redevelopment project in the U.S. today. Over the next 20 years, the Cleveland real estate outfit plans to transform what had been Stapleton International Airport—a 4,700-acre spread that would cover a third of Manhattan—into a full-blown community. Already, crews are completing a 740,000-square-foot shopping center to be anchored by big-box retailers such as Wal-Mart Stores Inc. and Home Depot Inc. And in April, construction is scheduled to begin on two schools plus 1,100 moderately priced houses and apartments.

Phase I won't be quite as grandiose as first thought, however. Forest City initially had proposed two office buildings, including a 12-story tower suited for a corporate headquarters, and dozens of estates to be listed at \$500,000 or more. But Denver's office vacancy rates are surging, and the market for upper-bracket homes is already glutted. So the developer scratched those properties. "We cannot create demand out of thin air," says Gregory M. Vilkin, president of Forest City Residential West Inc.

After a decade of prosperity, hard times may finally be catching up to the nation's builders. The overall economy tripped into recession in 2001, but not the construction juggernaut. Developers tallied an estimated \$481 billion in new starts in 2001, the 10th consecutive record year, according to F.W. Dodge, a McGraw-Hill Companies unit that monitors the construction industry. Employment in the sector also bucked the nationwide trend, rising while America's total payroll shrank by 1.2 million jobs. Despite all the dour news on Wall Street last year, most builders posted consistently higher earnings—prodding investors to bid up shares of some by more than 35%.

This year will be a different story. Growth could be worse than soft—it might be negative. If so, it would be the industry's first down year since 1991.

Corporate downsizing explains a lot of the poor prognosis. After

spending freely on new facilities and expansions in the past decade, many companies finding they have much more office, retail, factory space than they need, particularly they scale back operations to mitigate the recession's hammering. As a result, except health-care providers and discounters like Wal-Mart, few companies are ordering new buildings.

In the office sector, in fact, many are loading space, pushing vacancy rates at 30% in parts of Denver, San Francisco, Seattle, cities that once teemed with contractors readying space for dot-coms and tech startups. Only a few months ago, office developers expected to add 90 million square feet of space nationwide in 2002. Now, consensus has fallen to 60 million square feet. "Construction lenders have pulled back almost 100%," states Timothy H. Callahan, chief executive of Equity Office Properties Trust. "There's going to be six months to a year where we'll have no new construction."

Any contraction in construction could be trouble for the U.S., robbing the nation of one of the few bulwarks against the recession. Indeed, the sector's weakening is already rippling through the economy. Prices of lumber and other building materials such as dry-

LITTLER RED SCHOOLHOUSES

Montgomery County boasts the largest public school district in Maryland. It has more than 137,000 students, 10,700 teachers and a 1,100-vehicle bus fleet—plus a 10-figure operating budget, much of it earmarked for construction. In fiscal 2002, the district plans to spend \$135.5 million to build or rehab schools, roughly matching 2001's capital outlays.

While its student population is still growing, however, Montgomery County's cash drawer is looking emptier. In fiscal 2003, which begins July 1, spending on school construction will fall to \$105 million, forecast to remain at that reduced level for at least the next two years. "We're slowing down simply because the tax revenue isn't there anymore," says Richard G. Hawes, director of facilities management.

Montgomery County may well turn out to be the canary in the coal mine. As immigration and Generation Y have swelled enrollment in school systems across the U.S. have gone on a building boom.

ve plunged 40% to 60% since early 2000, ching Weyerhaeuser Co. and USG Corp., ong others. Oshkosh Truck Corp. cautions t sales of concrete mixers may skid 20% in 2, after a 30% drop in 2001. And Black & ker Corp. is bracing for a continued slide in er-tool and plumbing-parts sales.

Architects, engineers, and even interior decors might want to freshen up their ré-és—and soon. With few new projects com-in and existing developments wrapping demand for their services undoubtedly will line. “The 25-person office will all of a sud-become 18,” warns Allen Abend, chief of ol facilities at the Maryland State Educa-Dept., who oversees its design team.

Still, construction is not about to collapse. le nonresidential building starts will fall 7% in 2002, the decrease in total spending new projects will be 2% or less, predicts W. Dodge. The reason? By itself, housing ounts for roughly 45% of all new construc-in in the U.S., and though it is off from 9’s high, homebuilding is expected to hold dy in 2002. Inventories are one sign of ing’s underlying strength. At yearend, in-ories of unsold homes equaled 4.5 months ales. In the 1990-91 recession, by compari- inventories peaked at nine months.

Within the housing market, of course, there divergent trends.

ury-home sales are ing, as the rich suffer n a reverse wealth ef- “We’re in for several eaths of slower traffic,” its Thomas O. Weeks, ident of LR Develop-nt Co., which is build-

arts on educational o a record \$42.8 billion cording to F.W. Dodge. e recession squeezing ocal tax receipts, many e now finding they can fford to keep adding y. In New York, for he state has proposed

onstruction projects in 11 crowded districts until 2004. And he fund for school building is down to \$70 million, enough onstruct only the first seven schools on a waiting list of 185. eries are going to be repeated all around the country,” neth D. Simonson, chief economist of the Associated ontractors of America.

ime being, though, there is still some good news. Given that up to 15 months and \$10 million to build one elementary y is allocated well in advance. So much of the spending

ing 61 floors of high-end condominiums in Chicago. But demand at the lower end of the price range remains vibrant as low interest rates enable more people to buy a starter house or condo, or trade their way up. Pulte Homes Inc., for instance, plans to build as many as 28,000 homes nationwide in 2002, up 25% from 2001, as it shifts toward more modest models. “Right now, we would not be building higher-priced houses in San Francisco,” notes Mark J. O’Brien, CEO of the Bloomfield Hills (Mich.) company. “But overall, we feel our business is robust.”

Spending on public works such as schools, highways, and municipal infrastructure also is still on the upswing, though budget cuts at the state and local levels might force governments to stretch out or cancel projects as the year winds down. And construction of health-care facilities should continue to do well as an aging population requires more services. That’s turning out to be a godsend to Centex Corp. The Dallas developer says work for high-tech companies has evaporated, with no business anywhere on the horizon. But thanks to new contracts from schools and hospitals, Centex has \$2.1 billion in orders on its books—enough to keep its crews busy until 2004. By then, the recession should be only a memory.

By Michael Arndt in Chicago



STEPPING DOWN: School construction in Montgomery County, Md., is slowing because tax revenues can't keep up the pace

“Lenders have pulled back almost 100%. There’s going to be six months to a year where we’ll have no new construction”

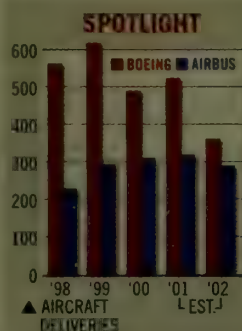
slowdown won’t be felt until 2003. Indeed, F.W. Dodge predicts that school construction starts will rise 5% in 2002, to nearly \$45 billion. Also, as the oldest members of Gen Y finish high school, more and more colleges and universities are

upping their construction budgets to accommodate the impending wave.

In addition, while many school districts are cutting long-term capital budgets, others are pushing ahead. Florida cut \$639 million from its education budget but added \$260 million for school construction. And North Carolina is moving on with its building program, thanks to a \$3.1 billion bond measure. But after the numbers get tallied, the construction industry is bound to come up with a smaller sum from schools—if not this year, then in 2003.

By Michael Arndt

PROGNOSIS 2002



Data: Airbus Industrie, Boeing Corp.

POSITIVES

- Military R&D and procurement will rise by about 5%
- With a federal bailout, airlines will be better positioned to buy planes

NEGATIVES

- If recession drags into 2003, struggling airlines will put off new orders
- The Pentagon can't afford to back missile defense, long-range bombers, and also more short-range fighter jets

PRODUCTIVITY

ECONOMIC VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 | 2002 EST.

\$58,000 | \$62,000

AVERAGE YEARLY CHANGE

1.7%

EMPLOYMENT

▲ = 250,000



3.1 MILLION

GROWTH PROSPECTS

C

2002

OUTPUT **\$192.0 BILLION**

OUTPUT GROWTH **1.3%**

1999-2001

AVG. YEARLY GROWTH **0.6%**

Data: Economy.com

THE FORTUNES—AND MISFORTUNES—OF WAR

By mid-2001, airline and aerospace executives knew they were in trouble. The economy was slowing. Overall air travel and high-yield business traffic were declining. As a result, the airlines were forecasting losses of up to \$2.5 billion. Then came September 11. Last summer's "downdraft in business travel and yields" was bad enough, recalls Robert W. Baker, vice-chairman of American Airlines Inc., "but 9-11 finished us off."

If the terrorist attacks decimated commercial airlines, they have had the opposite impact on America's defense contractors. Virtually overnight, downward pressures on the defense budget evaporated. Industry optimists now predict that the real jackpot will come in February, when the Pentagon is slated to unveil spending priorities for the next five years.

Indeed, the double-edged effects of the September tragedy are striking mixed chords at some giant aerospace conglomerates. Prior to 9-11, planners at Boeing Co.'s commercial division had been counting on a soft economic landing. Now, the unit is shedding up to 30,000 jobs, or one-third of its workforce, cutting production by nearly half—and as of December, writing off \$700 million to cover the economic impacts. Top suppliers of tires and engines, such as Goodrich, General Electric, and Pratt & Whitney, have likewise shaved thousands of jobs because the airlines have parked some 800 big, expensive airplanes and cut flights by at least 20%.

Boeing's defense division, in contrast, stands to get a lift. And the same goes for Northrop Grumman Corp., which had begun to shake off its low-grade image on Wall Street even before the terrorist attacks. In a vivid turnaround, Northrop consolidated its leadership in electronics and sensors by acquiring Litton Industries Inc. Then it beat out rival General Dynamics Corp. to acquire Newport News Shipbuilding Inc. But Boeing's year ended on a glum note: Lockheed Martin, the nation's No. 1 defense contractor, was picked to build the Joint Strike Fighter—at upwards of \$200 billion, the richest defense contract in history.

Overall, though, estimates from

the Aerospace Industries Assn. (AIA) bode well for the coming year. Net profits of suppliers of both commercial and military aircraft were climbed more than 5% in 2001, to \$1.5 billion, on \$151 billion in revenue. That was the sixth straight year the industry has reported profits above \$7 billion. But this year, the association predicts that total sales will dip 4.6%, to \$144 billion, as the full impact of September 11 begins to hit commercial plane deliveries in 2002 and 2003.

Demand for civilian jets and related services could decline sharply over the next years—and perhaps longer. The AIA expects Boeing to cut production from 522 airplanes in 2001 to 375 this year. Analysts and airline executives expect even bleaker numbers for 2002, ranging from 200 to 260 planes. Revenue from sales of commercial jets should decline to \$25 billion, from roughly \$35 billion in 2001. American Airlines' Baker now predicts the U.S. airline industry will lose upwards of \$1 billion in 2001—and is unlikely to see a recovery in 2002. "What we're doing is negotiating cancellations and deferrals of airplanes," he says. "The Boeings and Airbuses of the world will produce far fewer airplanes in the next few years than they had planned."

Some analysts do see positive signs emerging from the gloom in commercial aerospace. Large aircraft manufacturers have been shrinking their sprawling cold-war-era factories to build planes more cheaply and quickly. The turnaround will give the companies time



BIG BOOST: A defense missile

IS THIS A BUILDUP OR A BLIP?

With a military conflict in Afghanistan, a defense-minded Republican in the White House, and a rise in defense spending was predicted. Indeed, the 2002 defense budget passed in December jumped 11%, to \$343 billion. A haunting question for weapons makers: How long will the largesse last?

Blurring the picture, much of the increase is slated for helicopter, fuel, and rebuilding of an aging infrastructure—not weapons.



FOUND: Boeing's commercial division is shedding one-third of its workforce and slashing production by nearly one-half

airline factories further and make production lines more efficient. Layoffs will also be easier to justify, says Jon B. Kutler, chairman and CEO of Quarterdeck Investment Partners. September 11 provides domestic political cover, which will help them in the long run."

With slowing sales, Boeing's battle with rival Airbus Industrie will intensify, and both companies will feel the pain. Although U.S. aerospace exports last year jumped 13% over the previous year, imports soared to their highest straight record, according to the AIA. U.S. imports of Airbus jets rose \$1.9 billion last year, to \$14 billion. But the economic slump could force Airbus to cut production, from about 320 planes in 2001 to a predicted 275 this year. By 2003, it might be building as few as 275 jets.

On the military side, the key question is whether the Pentagon will spend its budget in a pinch. Because of the costs of the Afghanistan conflict, the Pentagon brass will have an even harder time funding all of their pet projects.

Weapons makers will see some new cash. While spending on military aircraft was flat in 2001, next year it's expected to rise 10%, to \$12.9 billion, according to the Aerospace Industries Assn. Boeing Co.'s Super Hornet fighter, as well as Lockheed Martin's F-22 Raptor fighter, could be big beneficiaries. And with the push for missile defense and smart weapons, spend- ing on missiles, which rose 14% in 2001, could climb 20%, to \$12.9 billion, predicts the AIA.

On the other hand, the total for research, development, and procurement in 2002 edged up to just \$108 billion, a 4.85% rise—and production, where the industry earns the most profit, will be flat at \$12.2 billion. The big bucks are likely to flow to companies making weapons, sensors, and unmanned vehicles—technologies

Despite the AIA's optimistic forecast of a 10% hike in spending on military planes, Gerald E. Daniels, CEO of Boeing's military-aircraft and missile-systems unit, expects procurement will remain flat compared with last year. Research and development will rise, he says, but most of it will be absorbed by the various ballistic missile defense initiatives.

The war on terrorism and heightened concerns about domestic security can only complicate the perennial contest among the armed forces for a beefier share of the de-

fense budget. Among the hard choices facing the Bush Administration are whether to emphasize bombers over fighters—and how much to shell out for homeland security vs. the military's basic operating expenses, already stretched by the war. "Is there really a source to fund all the trends?" asks Daniels. In total, the AIA says Pentagon aerospace buying will rise \$5.1 billion, to \$54 billion, in 2002.

The Afghan crisis and fear of additional domestic terrorist attacks have propped up the outlook for defense stocks. But commercial aerospace shares were sent into a tailspin. This year, the military's bright new image could translate into new dollars—for such high-tech marvels as the unmanned Global Hawk surveillance planes, or for replacing the Air Force's aging tanker fleet with modified Boeing 767 airliners. No such luck for commercial aircraft builders. For them, the best hope is that the situation doesn't get worse.

By Stanley Holmes in Seattle, with Stan Crock in Washington, D.C.

The terrorist attacks decimated commercial airlines. Spending on military planes, however, is now expected to rise 10% in 2002

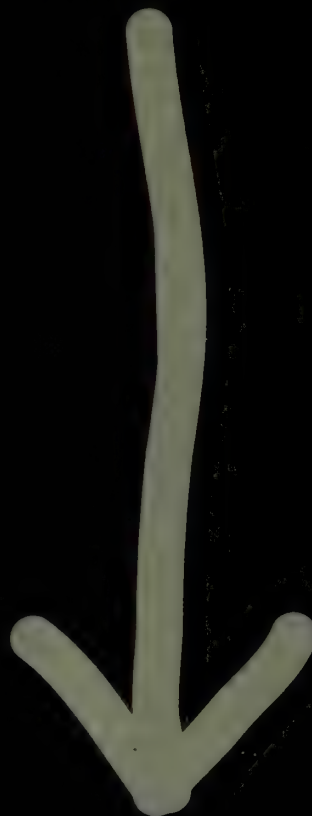
dominated by Raytheon, Northrop Grumman, Lockheed Martin, and Boeing. More money could come from the September 11 emergency-spending measure, though the amount isn't certain. Much of the antiterrorism funding will go to intelligence, however, not traditional arms.

Even this modest party may be short-lived. "I expect this to be a one-year blip," says Jon B. Kutler, chairman and CEO of Quarterdeck Investment Partners, an investment bank that specializes in the aerospace industry. Robert Friedman, a defense analyst at Standard & Poor's, adds that once the war on terrorism cools down, Social Security and Medicare will be on the front burner again. The guns vs. geezers debate will keep a lid on "outsized increases in the defense budget," he says. In fact, for 2003, the Pentagon may be lucky to get a 3% boost.

By Stan Crock

RETURN ON COMMUNICATIONS

WEB SITE
TRAFFIC



WEB SITE
TRAFFIC JAMS

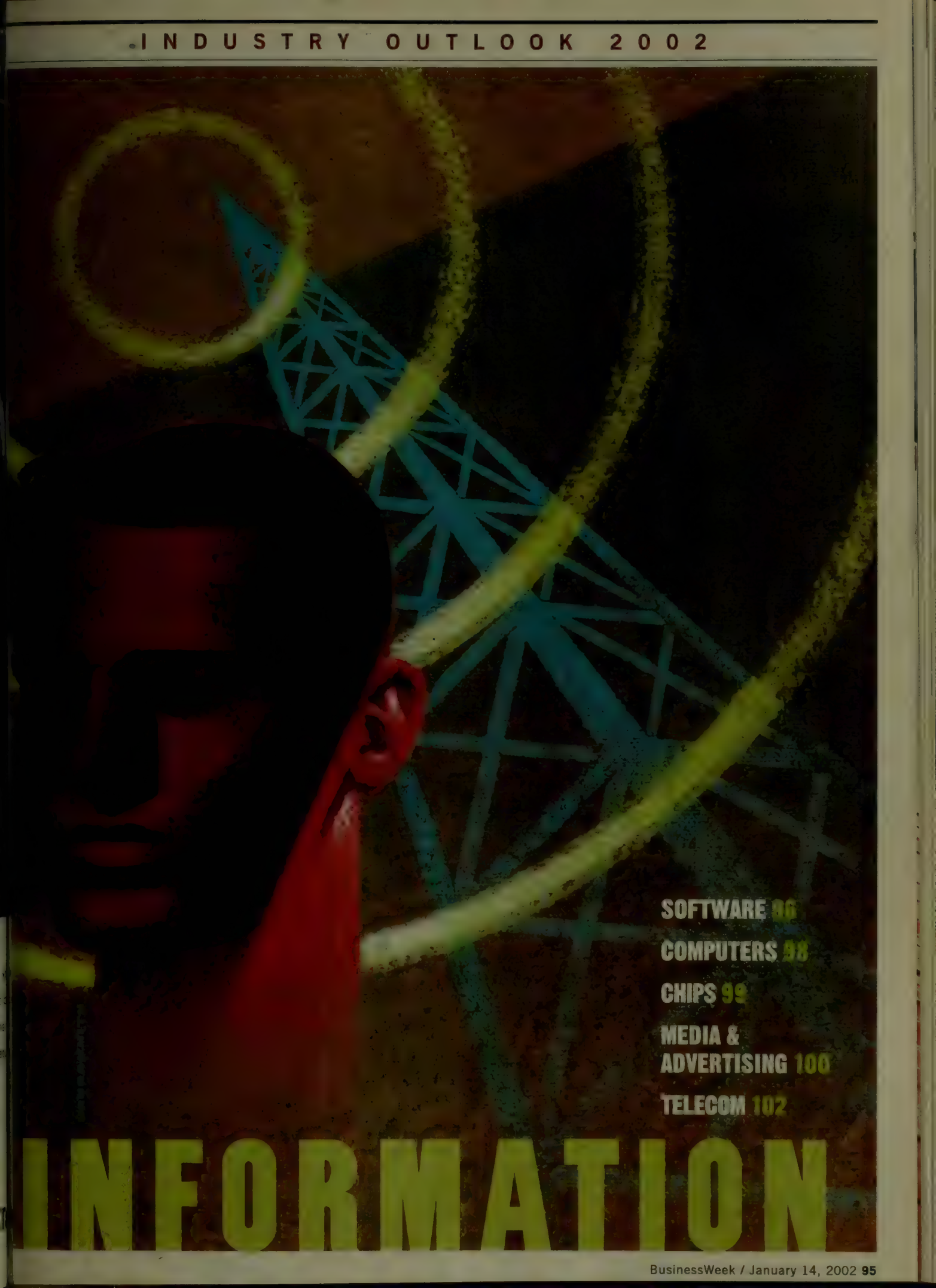
You can't have too much of a good thing. Unless you're talking Web transactions—and your network can't handle the load. After **Nabiscoworld.com** launched, the site managers faced exactly this issue: too many visitors were arriving at the site. Which meant too many people were turned away. Unhappy. AT&T solved the problem. We re-architected the site to handle double the current monthly visits. And we added performance tracking and data-capture tools to squeeze out more usable

information. Result: Nabiscoworld.com receives 90% more visitors. With no change in response time. And at greatly reduced cost. It's proof that the right investment in your communications not only solves problems. It brings an immediate return. A return AT&T helps you realize.

Got a traffic problem? AT&T can help you solve it.

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SOFTWARE 86

COMPUTERS 98

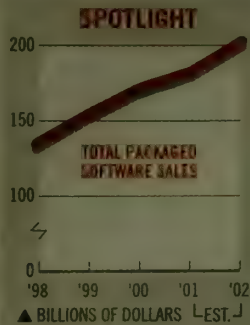
CHIPS 99

**MEDIA &
ADVERTISING 100**

TELECOM 102

INFORMATION

PROGNOSIS 2002



Data: International Data Corp.

POSITIVES

- Fear of cyberterrorism and viruses will help the security-software market grow 18%, to \$4.3 billion
- Data-storage software will gain from spending on disaster-recovery systems

NEGATIVES

- Sales of enterprise software systems will shrink 10%
- E-commerce software sales, which shrank by more than 30% in 2001, will creep back by just 3%

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 2002 EST.

\$114,000 \$115,000

AVERAGE YEARLY CHANGE

0.2%

EMPLOYMENT

↑ = 250,000



2.2 MILLION

GROWTH PROSPECTS

C

2002

OUTPUT \$249.4 BILLION
OUTPUT GROWTH -0.3%

1990-2001

AVG. YEARLY GROWTH 7.8%

Data: Economy.com

FEW BRIGHT SPOTS, APART FROM THE HOME PC

Last February, Oracle Corp. staged a pull-out-all-the-stops customers' conference topped off by a rock concert at the Louisiana Superdome in New Orleans. There, Oracle CEO Lawrence J. Ellison happily speculated that his business software company would turn out to be "counter-cyclical" to the rest of the economy. In an effort to cut costs and boost efficiency, he reasoned, Oracle's customers would buy more and more of his database software and applications.

That's not how things turned out. In fact, within a week of that speech, Oracle closed out its worst quarter in nearly three years—with revenues about \$200 million short of Wall Street's expectations. Indeed, Oracle was the first major software house to get caught off guard when tech spending dried up last year.

To be fair, Oracle, which made more than \$3 billion in profits last year, wasn't the hardest hit. Highfliers like Ariba Inc. and Commerce One Inc. saw software-license revenues drop by as much as 50% over the course of the year. Even rock-solid Siebel Systems Inc., a customer-management software company whose revenues doubled the previous year, was left staring grimly at zero growth for 2001.

Mercifully, the software industry's *annus horribilis* isn't likely to be repeated. International Data Corp. says global sales of all packaged software, excluding services, could increase 10.7%, to \$202.5 billion, in 2002, about double the growth rate for 2001. Other market researchers are less ebullient, especially given weak demand in software services. But nearly everyone agrees that the picture has brightened.

Consumer software is driving the growth this year. The segment, which includes everything from Microsoft Corp.'s Windows XP operating system to accounting programs for small businesses and games like The Sims, has been a big laggard for the past several years. But now that business spending has slumped so far, retail software spending doesn't look so bad. Within 15 days of XP's launch on Oct. 25, shoppers snapped up about 7 million units, outpacing all other versions of Windows, according to Microsoft. And upgrades of other programs, timed to coincide with the release of XP,

are helping. All told, market researcher Techworld says 2001 sales of retail software will easily top \$105 billion, up 3% from 2000, and comparable growth is expected this year.

As for corporate-focused software, Dataquest Inc. forecasts 2% growth in 2002, to \$81.8 billion. Maybe. If the economy's fourth quarter of 2001 was as weak as it seemed, companies will hold off big software purchases in early 2002 as well. Sales may pick up later in the year, but "only if the economy comes back—otherwise it's likely to be a flat-to-down year," says Thomas P. Bergstrom, managing director at Goldman, Sachs & Co.

After 2001, any improvement will be hard to come. For the first time in a decade, software sales to midsize and large businesses are expected to drop by about 1%, to \$78 billion, in 2001, according to Dataquest. Leading the way down were the highfliers of 2000: Internet commerce software makers, with off more than 30% for the year. "This was such an anomaly compared to all the others," says Joanne Morin Correia, a Dataquest vice-president.

So when will corporate buyers find their checkbooks again? Charles J. Bay, CEO of software maker Kana Software Inc., expects noticeable improvement in the fourth quarter, but he says sales have stabilized. Oracle's Ellison isn't offering any specific forecasts, but he says sales have stabilized. Recovery is due in 2002. Market researchers are less circumspect. Dataquest says sales of big enterprise software systems to manufacturers like human resources and manufacturing will drop 10%, to \$4.88 billion.

BEA: STALKED BY GIANTS



CEO CHUANG

For most of 2001, BEA Systems Inc. of San Jose, Calif., seemed impervious to the tech wars. Customers such as Charles Schwab & Co. were spending millions of dollars' worth of the company's software—essential programs for building and managing Internet infrastructure. In this niche, the old BEA was both the biggest and the best.

Now, competition and a lousy economy have finally caught BEA. On Oct. 31, the company disappointed Wall Street for



WINDOWS XP: Retail software will drive growth this year

Whatever happens to the economy, most industry experts anticipate vigorous spending at least three types of software. Sales of security programs should rise about 18% in 2002, to \$4.34 billion, according to Dataquest. Customer-management software from companies such as Siebel will also grow about 18% in 2002, to \$14 billion, according to AMR. A third growth area is the important market for infrastructure software that links big computing systems. Sales in this niche will jump 13.5%, to \$2.2 billion, according to Dataquest. In the infrastructure category, Giga Information Group Inc. is particularly bullish about application servers—the building blocks of e-business systems. Sales should grow from about \$2.3 billion in 2001 to about \$3.5 billion this year to \$9 billion in 2004. Then there's Microsoft. The company's stranglehold on the PC software market insulates it in the worst of downturns. "Whether one thing happens super, super, super well or just not so well next year, we're in the game, we're going to stay in the game," says Microsoft CEO Steven A. Ballmer.

The software giant launched a raft of new

products in 2001—everything from Windows XP to its Xbox game console. Moreover, it gained ground on such archrivals as Sun Microsystems Inc. in the server business and Oracle in the database software market. Dataquest expects that slice to be worth \$8.77 billion in 2002, up 1.6% from 2001. While competitors' sales dipped, Microsoft's revenue increased 10% in the fiscal year that ended June 30, 2001. For fiscal 2002, Microsoft expects revenue to climb about 14%, to \$29 billion, and operating income to grow about 4%, to \$12 billion.

Microsoft won't launch as many products in 2002. At least one of them, however, an upgrade called Visual Studio.net, should make a splash. Although it's just a set of tools for software developers, Visual Studio is the foundation of much of Microsoft's power. The new version, due out Feb. 13, will include Microsoft's first all-out effort to shift its huge army of developers toward building Web services, which are programs that communicate with other types of software to make life easier for people who want to shop or browse or organize their businesses online.

Web services, in fact, are the playing field on which this year's software battles will be fought. Just about every major software company has a strategy. "Think about what happened with the browser," says Vivek Y. Ranadivé, CEO of Tibco. "Now imagine if you could bring that same ease of use to something that really matters," like automating an entire business and allowing different kinds of software to work easily together. That, software experts agree, will be key to an industry turnaround...if there is to be one at all.

By Jim Kerstetter in San Mateo, Calif., with Jay Greene in Seattle

Corporate America will avoid software splurges, except for certain niches, including security

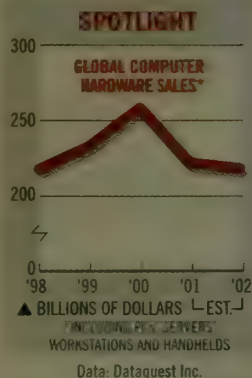
it went public four years ago. Revenues for the third fiscal year ending Oct. 31 were \$219.6 million, down \$4 million from the previous year. Its pro forma income was \$24.2 million, down \$7 million from the same quarter in 2000.

Compared with Net software wrecks like Ariba Inc. and Commerce One, BEA still looks pretty good. But what comes next? There are a lot of big companies like IBM and Sun Microsystems could end up competing with BEA in the coming year. IBM, for example, boosted its share of the application server market to 34% in 2001, up from 31% in 2000. At the same period, estimates Giga Information Group, BEA's market share will hold steady at 36%. But now, Oracle Corp. is discounting its market and has BEA square in its sights.

To get out of this pickle, CEO Alfred Chuang says BEA will have to expand beyond its core "Web-application server" business. Today, its programs act like building blocks for big e-business projects. But the future lies in so-called Web services, meaning disparate Net-based programs that work together without any human intervention. On July 10, BEA acquired tiny Crossgain Corp. to help it get a grip on Web services. Chuang has also added Web portal capabilities, so BEA's licensees can create Internet portals that are shared by their staff, customers, and business partners. "We are going to force our competition to continue to play catch-up," says Chuang. But as the CEO will be the first to admit, if the pack ever does catch up, BEA could be mangled.

By Jim Kerstetter

PROGNOSIS 2002



POSITIVES

- Recovery should eventually reboot demand for all types of hardware
- Some companies will buy cheaper, easier-to-manage servers—even if the turnaround is delayed

NEGATIVES

- Pricing pressure will continue to hurt manufacturers' profits
- Many businesses will make do with existing PCs, stretching life spans from three years to four

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 | 2002 EST.

\$61,000 | \$94,000

AVERAGE YEARLY CHANGE

11.4%

EMPLOYMENT

▲ = 250,000

1998 | 2002 EST.

1.1 | 1.2

0.3 MILLION

GROWTH PROSPECTS

D

2002

OUTPUT \$31.2 BILLION

OUTPUT GROWTH -2.3%

1998-2001

AVG. YEARLY GROWTH 7.4%

Data: Economy.com

MORE TORTURE FOR TECH

Met Ross W. Holman, chief information officer of penny-pinching Southwest Airlines Co.—a.k.a. Michael S. Dell's worst nightmare. All last year, Dell predicted that computer demand would snap back in 2002 as PCs bought to prepare for Y2K turn three, the usual retirement age. But Holman plans to keep his computers for four or even five years. It's one small way Southwest has stayed profitable in a pinch. And besides, as Holman notes, "we're not even using all the horsepower we have."

In 2002, frugal is still fashionable among tech buyers, and that spells trouble for the battered computer industry. As they wait out the recession, tightfisted corporations aren't loosening up from last year, when total sales of computer gear collapsed by 14.3%, hitting \$221.5 billion. Consumers remain equally cautious. So from a diminished base, overall computer hardware sales are expected to fall 1.7% this year, to \$217.7 billion, according to market watcher Dataquest Inc.

With the sector's growth potential flagging, consolidation is imminent. Wall Street's chilly reception to Hewlett-Packard Co.'s plans to merge with Compaq Computer Corp. might put the kibosh on it and other big tech mergers for some time. But poor demand and price wars will force weaker companies to keep cutting back and cede key markets to stronger players, such as Dell Computer Corp. Already, profit woes have caused Toshiba Corp. to abandon the U.S. desktop market and Gateway Inc. to quit selling abroad.

For those left standing, it will be a slow ascent out of the doldrums. Take PCs: A year ago, manufacturers were bemoaning the end of the heady growth of PC sales. Now they'd be happy with any growth at all. Sales fell 16.5% last year, to \$161.2 billion, the industry's first-ever decline. With corporate buyers like Holman content to hold on to their current PCs, the average life span of each unit is stretching beyond four years.

True, PC users who really want Windows XP may buy new machines with the software pre-installed. But so far, there's no stampede. And while PC makers want to believe that the pro-

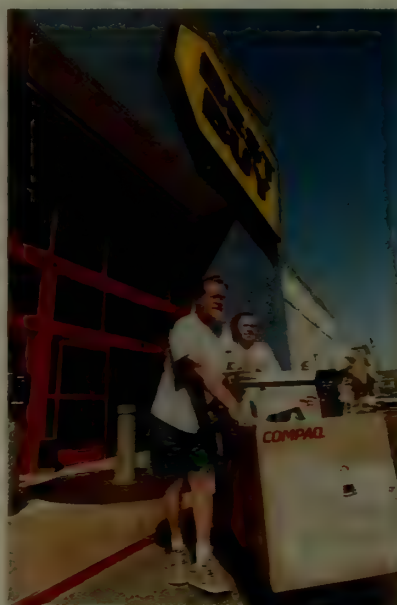
liferation of broadband Net connection spur PC sales, some analysts are dubious. For that is "like watching grass grow," says Needham & Co. analyst Charles who doesn't expect a PC resurgence until

Worse yet, the price wars that dilute year's revenues rage on. PC price tags fell in 2001, according to market tracker Nitelect, and they'll continue to drop until demand returns. Even then, buyers accustomed to bargains aren't apt to accept higher prices. The result: Although unit sales of PCs will slightly this year, revenues will fall 4.3%

\$154.3 billion.

One hot spot for hardware makers is small devices as handhelds. And as wireless e-mail catches on, sales of handhelds—led by devices that run the Palm Inc. operating system—will grow a hearty 28%, to \$4.6 billion, says Dataquest.

High-end computer makers will be green with envy. Companies are still trimming costs, and that's hurting server sales. In 2002, revenue in this arena will grow 5.2%, to \$52.7 billion, with biggest gains in low-price machines running Microsoft Corp.'s Windows network software. One reason for sluggish rebound: The cost of an average server will fall 10%, to \$9,900, after a 1%



BARGAINS: Bad news for the industry, good deals for shoppers

decline last year, says Dataquest's Jeffrey Witt. To jump-start sales, server makers such as IBM, Compaq, and Sun are encouraging customers to spend now on more-efficient machines that can save big down the road.

Also under pressure are sales of high-capacity storage drives, but they're expected to bounce back faster. Companies looking to consolidate their stores of data on more efficient networked systems will help boost sales 12% to \$17 billion. That will leave the sector's share of the \$18 billion peak hit in 2000—and market leader EMC Corp.'s scramble to more disk drives, software, and services.

All this bad news is good for customers. Thanks to the recession, they are learning to keep info-tech spending under control. Those that do go shopping find a market full of bargains. So long as the economy is soft, tech's resurgence will be far out of sight.

By Andrew Park in Dallas

OGNOSIS 2002

SPOTLIGHT



Data: SIA

POSITIVES

Discounted processors, memory mean cheaper PCs and other gadgets

Orders for networking gear, PCs, handhelds could boost chip demand

NEGATIVES

Overcapacity still lags the key telecom- and memory-chip markets

Price wars have forced many chipmakers to cut workforce and consider mergers or consolidations

PRODUCTIVITY

VALUE ADDED PER EMPLOYEE, '01 DOLLARS

1998 2002 EST.

\$81,000 \$145,000

AVERAGE YEARLY CHANGE

15.8%

EMPLOYMENT

↑ = 250,000

0.6 MILLION

GROWTH PROSPECTS

C

2002

OUTPUT \$87.0 BILLION

OUTPUT GROWTH 0.8%

1998-2001

YEARLY GROWTH 13.0%

Data: Economy.com

NOWHERE TO GO BUT UP

Flip the calendar back a year, and the semiconductor industry could hardly have imagined the carnage that awaited. Sure, PC sales had already tanked, but about 55% of all chips were going into other products—cellular phones, digital games and gadgets, and industrial equipment. Chipmakers thought the broader diversification would shield them from the vagaries of the PC business, which had long been a mercurial taskmaster, gobbling up more than half of all chips.

There was even hope that increasing market diversity would help insulate the sector from its historical boom-bust cycles. Sorry, guys. Weak consumer and corporate demand, excessive inventories, and a shaken U.S. economy slammed the brakes on the double-digit growth found during the go-go dot-com years. Chip sales skidded 31% last year—the worst downturn ever, according to the Semiconductor Industry Assn. (SIA).

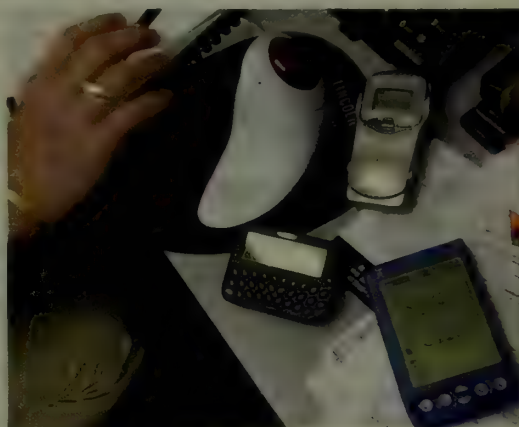
Now, chip companies hope to take a page from *The Little Engine That Could* and climb out of the slump. Manufacturers that use chips to imbue their hardware with smarts are slowly placing new orders. And chipmakers such as Intel Corp. and Advanced Micro Devices Inc. (AMD) are holding firm on prices—at least for now. What's more, consumers are pitching in to help. Holiday sales of notebook PCs, video games, and snazzy digital music players like Apple Computer Inc.'s iPod showed surprising strength. Demand for consumer-electronics gear should help push global semiconductor sales up at least 6% in 2002, to \$150 billion, the SIA predicts. Its confidence is buoyed by the slow but steady sales growth since last summer.

Still, nobody's celebrating just yet. Execs at companies such as Intel, Motorola, and Texas Instruments say even though they're getting ready to deliver new technologies that make chips faster and less power-hungry, the economy is still the big unknown. "I wish I had a crystal ball," says Michael Ponzo, marketing director for Motorola Inc.'s digital signal processors unit. His best guess: After a slow start, 2002 will get better in the second half.

For microprocessors and memory chips, things could be looking up even if demand re-

mains weak. Intel and rival AMD have held the line on chip prices, a turnaround from the intense tit-for-tat battles that forced them to cut thousands of jobs and sent their stock prices tumbling. If prices hold firm through 2002, gross margins should improve, says Intel Chief Financial Officer Andy D. Bryant. Meanwhile, memory-chip suppliers such as NEC, Micron Technology, and Hynix Semiconductor (the result of the Hyundai-LG Semicon merger) are scrambling to negotiate alliances and consolidate manufacturing to rid themselves of the surplus capacity. Giant Toshiba Corp. is going further, announcing plans to back out of commodity memory chips altogether.

Much of the action this year is expected in chips for wireless gear, especially cellular phones. As next-generation wireless networks are deployed to give consumers better access to the Internet, Yankee Research Group Inc. estimates about 435.7 million handsets will be sold in 2002, up about 10% from last year's 395 million units. That could help give the market some much-needed pep, particularly since handsets use about 7% of all chips. And cell phones aren't the only hot gadgets. At a Morgan Stan-



GROWING PAINS: Chip orders are picking up, but slowly in the profitable high end

ley Dean Witter & Co. conference in December on information-technology spending, chief information officers were keen on Internet-capable handhelds such as Compaq Computer's iPaq, Research in Motion's BlackBerry pagers, and new cell phone-computer combos like Handspring's Treo line.

The wild cards, though, are chips for traditional wired telecom and Internet equipment. Asian foundries, notably Taiwan Semiconductor Manufacturing Co., are still saddled with massive overcapacity, but things are starting to pick up, says Merrill Lynch & Co. analyst Mark Lipacis. For telecom chip vendors such as Broadcom Corp. and Conexant Systems Inc., 2002 could be financially rough because most orders have been for low-end products, not the high-end specialty chips that bring juicy profits. "Looking past [March], there is optimism but no visibility," Lipacis says. At a time when the chips have never been more down, that's almost uplifting.

By Cliff Edwards in San Mateo, Calif.

PROGNOSIS 2002



Data: Universal McCann

POSITIVES

- DVD sales will rise to \$420 million, up 46%
- With digital cable subscriptions surging—up 68%, to \$9.7 billion—media producers have more channels to fill

NEGATIVES

- As advertisers cut spending, media revenues will fall
- The recession and file-sharing will plague the music business—sales will fall by 3% worldwide

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 2002 EST.

\$95,000 \$91,000

AVERAGE YEARLY CHANGE

-1.0%

EMPLOYMENT

▲ = 250,000



2.0 MILLION

GROWTH PROSPECTS

D

2002

OUTPUT \$186.2 BILLION

OUTPUT GROWTH -1.9%

1998-2001

AVG. YEARLY GROWTH -0.2%

Data: Economy.com

ADVERTISERS ARE STILL HIDING OUT

Welfare mother and aspiring author J.K. Rowling probably wasn't thinking of media industry returns when she sat down in 1990 to write a fantasy novel about an 11-year-old wizard. But Harry Potter ended up being about the only magic in an otherwise dreary 2001 for the media and entertainment business. Warner Bros.' movie adaptation of Rowling's *Harry Potter and the Sorcerer's Stone* is expected to pull in \$400 million in box office receipts by yearend and upwards of \$250 million in sales of Potter paraphernalia ranging from broomsticks to video games.

While Rowling and Warner triumphed, however, the rest of the media world suffered through its toughest year in a decade. Total U.S. media revenues contracted by \$10 billion to \$575 billion last year, knocked backward by the one-two punch of the post-dot-com advertising crash and the terrorist attacks. And although 2002 will be better, the media world will be hard-pressed to grow by more than 5%, forecasts media merchant bank Veronis Suhler & Associates—down from an annual growth rate of about 8% between 1995 and 2000.

This year does promise a few hot tickets. Still-sizzling sales of older movies on DVD and a lineup of potential big-screen blockbusters that include new installments of Star Wars, Harry Potter, and James Bond are some of the likely high points. And there should be some heavy action on the deal front, where consolidation in the cable and satellite TV world will likely prompt a new round of mega-mergers. "The patients may have been wounded, but they are up and taking nourishment," says UBS Warburg media analyst Christopher Dixon.

Media companies have developed various new revenue streams over the years, from subscription sales to licensing fees. But ad spending is still the lifeblood for most of the industry. So it's hardly reassuring that advertising will rebound only modestly this year. After a banner 2000, when advertising expanded by 10%, ad expenditures shrank by 4% in the U.S. in 2001, according to media buyer Universal McCann. Worldwide, the sector retreated by 1.7% in the same period—the first global decline suffered since World War II.

This year the industry will see a little rise with a modest anticipated rise in world advertising of 2.2% to \$466 billion. Still, buys for midterm elections and the Winter Olympics in Salt Lake City will likely give the ad sector a jolt, but mainstream spending may not pick up until later in the year. The once-heralded sector of Internet advertising will be flat this year at \$4.1 billion, according to Universal McCann. "The gloom hang around at least until the third quarter, not later," says James DePonte, a media consultant at PricewaterhouseCoopers. The sectors most heavily hit, figures DePonte, are magazines, radio stations, and networks.

Slack ad sales will likely force media companies to continue to trim operations and lay off workers, following a year in which about 100,000 workers in media and advertising received pay slips. Surviving media players will no doubt also increase their search for merger partners with whom to share costs. Consolidation in the magazine world, in which more than 90 titles folded in 2001 (vs. 37 in 2000) will likely accelerate, figures Peter Kreisky, president of Boston-based Kreisky Media Consultancy. Another likely deal may involve internet service provider Yahoo! Inc., which has been restructured under new CEO Terry Semel. Its 68 million visitors are being eyed by major media players Viacom and France's Vivendi Universal—and possibly the Walt Disney Co., as well.

The biggest deals, though, will probably be in the TV world, where Comcast Corp.'s purchase of AT&T's cable systems could prompt

VIDEO GAMES: THE SKY'S THE LIMIT



BULL'S-EYE: Xbox

All you need to transform yourself into Harry Potter, a professional football player, a bionic soldier fighting aliens on a distant planet is a TV and a video-game console. Two consoles that reached the market in 2001—Microsoft's Xbox and Nintendo's GameCube—flew off store shelves

faster than Harry flies his powerful broomstick, setting up what could be the strongest year ever for video-game hardware and software.

Despite the faltering economy, most of the estimated 1.3

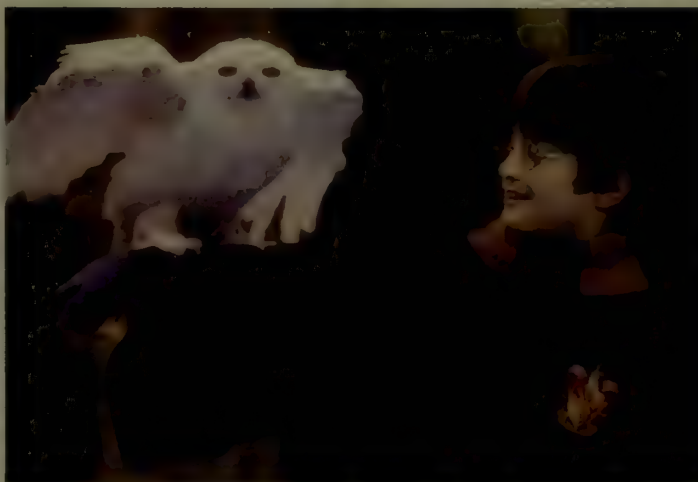
ve of couplings. Smaller players
h as Cox, Charter, and Cablevi-
a will surely be looking for
ger partners to achieve greater
le. EchoStar Communications
p.'s deal to buy General Motors
p.'s DirecTV satellite service will
tough antitrust questions in
shington, and losing bidder Ru-
Murdoch's News Corp. may
emerge to make an offer. Fam-
entertainment broadcaster Pax-
Communications Corp. may
be on the market after the 65-
ion TV group filed suit to free
lf from 32%-owner NBC.

The winners in the consolidation
e are hoping to sell movies-on-
and, home shopping, and other

ractive TV services to subscribers who are
ly being offered digital TV. The number of
vers paying up for digital cable will grow to
million this year from 12.3 million in 2001,
mates Pricewaterhouse Coopers. Combined
an increase in satellite TV customers, some
million homes—or about 40% of all TV house-
s—will have a digital signal by yearend, ac-
cording to consultants the Carmel Group.

ll told, consumers will spend \$37.6 billion on
e and satellite services in 2002, says Price-
rhouse Coopers, a 10.6% hike from last
t. New services for cable consumers will in-
e Movies.com, a movies-on-demand service
n Disney and Fox Entertainment group.
er to bypass Blockbuster, three studios—
y, Universal, and Warner Bros.—will also
a movies-on-demand service, called movie-
ver both digital cable and the Internet.

etting such digital services up and running
be tough, though. Just look at the music in-
ry, which after several delays finally
ched rival online subscription services late
year, even as music sales worldwide
ped. Downloads from pirate sites were a
or contributing to an 11% decline in U.S.



HARRY POTTER: An expected box office of \$400 million

music sales in 2001, to \$32.8 billion, says Merrill
Lynch & Co. This year's estimated decline: 3.4%.

With ad sales still uncertain, the media
world this year will look to its often-risky Hol-
lywood units for growth. More than 58 million
U.S. homes are expected to have DVD players
by the end of 2002, and consumers are ex-
pected to spend \$9 billion to buy DVDs—a 33%
hike from 2001, forecasts Adams Media Re-
search. By contrast, U.S. homes are expected
to spend \$5.4 billion on videocassettes, a 14%
decline from 2001. And Hollywood has more
hits coming. Likely blockbusters in 2002 will in-
clude follow-ups to *Austin Powers*, *Men In
Black*, and *Stuart Little*, as well as *Star Wars
Episode II: Attack of the Clones*. Steven Spiel-
berg will deliver his futuristic *Minority Report*,
starring Tom Cruise. Harry Potter will also
lend a hand, with another film expected around
Thanksgiving.

This time, the industry is hoping the little
wizard gets some help from other films, so he
can conjure up a stronger rebound for the me-
dia world.

*By Tom Lowry in New York and Ronald
Grover in Los Angeles*

Look for
more cable
and
satellite TV
mergers as
midsize
players
bulk up to
address the
growing
demand
for digital
services

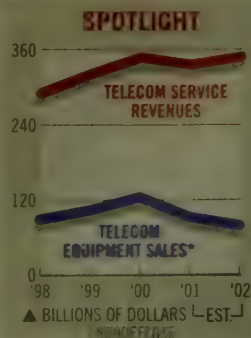
s and 1.4 million Xboxes shipped by manufacturers in
rica before Christmas sold quickly. Sony's PlayStation 2
ell, with an estimated 1.4 million boxes sold in the fourth
al U.S. video-game hardware sales climbed to \$6.4 billion
of November, up from \$4.7 billion in the same period the
ear, according to NPD Funworld. And worldwide sales of
ould jump 27.6%, to \$9.7 billion, in 2002, predicts Sound-
ology analyst Shawn Milne.

nging cash registers bring smiles to game publishers as
are purchases, led by publishers such as Electronic Arts,
w 16.1%, to \$20 billion, worldwide, Milne says. Electronic
is responsible for such best-sellers as Madden NFL 2002

and Harry Potter and the Sorcerer's Stone—should see revenues in-
crease 35%, analysts say, to \$2.2 billion. After September 11, some
worried that a collective aversion to violence would slam game sales,
but that fear was short-lived. The industry has shelved or altered lit-
tle of its material since the terrorist attacks. That's because the
most violent games, rated "M" for mature, account for only 7% of
the industry's annual revenue. "We haven't shipped an M-rated game
in over a year," says Peter Moore, chief operating officer of Sega of
America. "They just don't sell." Otherwise, the year is off to a rollick-
ing start for video games—and for the wizards, soldiers, and sports
stars who populate the players' fantasies.

By Arlene Weintraub in Los Angeles

PROGNOSIS 2002



Data: Census Bureau

POSITIVES

- U.S. mobile wireless carriers will roll out faster, always-on Net access
- Broadband subscribers will double, to nearly 20 million

NEGATIVES

- In a blow to equipment makers, carriers will continue to cut capital spending by 15% to 30%
- Capital markets will remain shut for all but the most conservative telecom companies

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 | 2002 EST.
\$141,000 | \$182,000

AVERAGE YEARLY CHANGE
6.7%

EMPLOYMENT

↑ = 750,000



1.4 MILLION

GROWTH PROSPECTS

C

2002
OUTPUT \$255.2 BILLION
OUTPUT GROWTH 1.1%

1995-2001
AVE. YEARLY GROWTH 3.5%

Data: Economy.com

THE LONG MORNING AFTER

Suppose the U.S. economy staged a recovery this year. Would that rescue telecom, the certified international basket-case of 2001? Not likely. This industry, which disgraced itself with wanton overinvestment in the late 1990s, is still absorbing excess capacity. The capital-funding problems, bankruptcies, job losses, and blown financial targets that roiled the industry last year are bound to drag on. "If anything, the general environment for communications will be worse during the coming year," says analyst Ken Leon, who follows telecom equipment for investment firm ABN AMRO.

In the hunt for early indicators, analysts and investors are scrutinizing capital spending—and don't like what they see. The industry is still recovering from a binge that culminated in 2000, when U.S. equipment spending by carriers rose 30% from the previous year, to \$110 billion. Massive fiber capacity was put in place, but demand for services couldn't keep pace, leading to a backlog of inventories of communications equipment—and ultimately, to bankruptcies. ABN AMRO's Leon, whose team surveyed hundreds of telecom carriers worldwide, says there are more spending cuts to come. On a global

basis, he says, capital expenditures actually declined only 1%, to \$274 billion, in 2001—thanks to increases in China and Latin America. This year, cuts will be more widespread, leading to a global downturn of 17%, to \$228 billion.

Decreased spending on gear will hurt equipment makers like Nortel Networks Corp. and Lucent Technologies Inc., which are already in the red. Lucent warned investors in December that revenue for the first fiscal quarter will be just \$3.1 billion, about 30% below expectations. Lehman Brothers telecom-equipment analyst Steven D. Levy says Lucent, which has cut its workforce by about 50%, to 60,000 or so, could be forced to make even more cutbacks in 2002.

The downturn in telecom spending could also slow the recovery of the tech sector and the economy overall. Telecom companies are a big part of the tech food chain. Sun Microsystems Inc. got 36% of its 2000 revenue in the communications sector, for example. Tech companies will have a hard time posting strong growth without telecom. And the economy, in

turn, is heavily dependent on tech: The drove about 30% of the nation's growth in the long bull market.

The availability of credit will also be an issue in 2002. Credit windows were shut last year, pushing upstart voice and data carriers such as Winstar Communications Inc. and Teligent Inc. into bankruptcy. The window opened a crack recently, at least for large companies. In the fall, for example, Lucent offered \$1.75 billion in convertible stock and AT&T offered \$10 billion, including euros. Even fifties newcomer Ciena Corp. was able to get debt. "Interest rates are at a record low, so the debt market is reasonably receptive to companies with a good story," says Bruce Hyman, telecom analyst at Standard & Poor's Corp.

One bright spot should be the wireless industry, which will get a boost from the roll-

out of new data services. AT&T Wireless will match the speed of dial-up modem connections, allowing customers to surf the Web and change e-mail using phones and other devices. AT&T Wireless will roll out these services by yearend. Sprint PCS, Verizon, and Cingular have similar plans. "We are going to have a serious push into new services, and you



SURFING'S UP: Wireless will get a boost from the rollout of new data services

start to see the 'doCom influence' shape business model," says AT&T Wireless CEO Zeglis. (NTT doCom, Japan's wireless data carrier, has a partnership with AT&T Wireless.)

Broadband access for consumers will be too. The total number of high-speed Internet subscribers nearly doubled, to about 11 million in 2001. J.P. Morgan Chase & Co. says the number of households with broadband will increase about 50% in 2002, to 17 million.

The most important changes in telecom this year may be driven by Washington. Federal Communications Commission Chairman Michael Powell, a Bush appointee, has a more laissez-faire approach than his predecessor, William Kennard. So he may allow more Bells into long-distance markets of many states. He also may be less aggressive about forcing carriers to share their DSL equipment with rivals. That'll be a blow for competition—and encourage the Bells to speed deployment of their own DSL services.

By Steve Rosenbush in New York

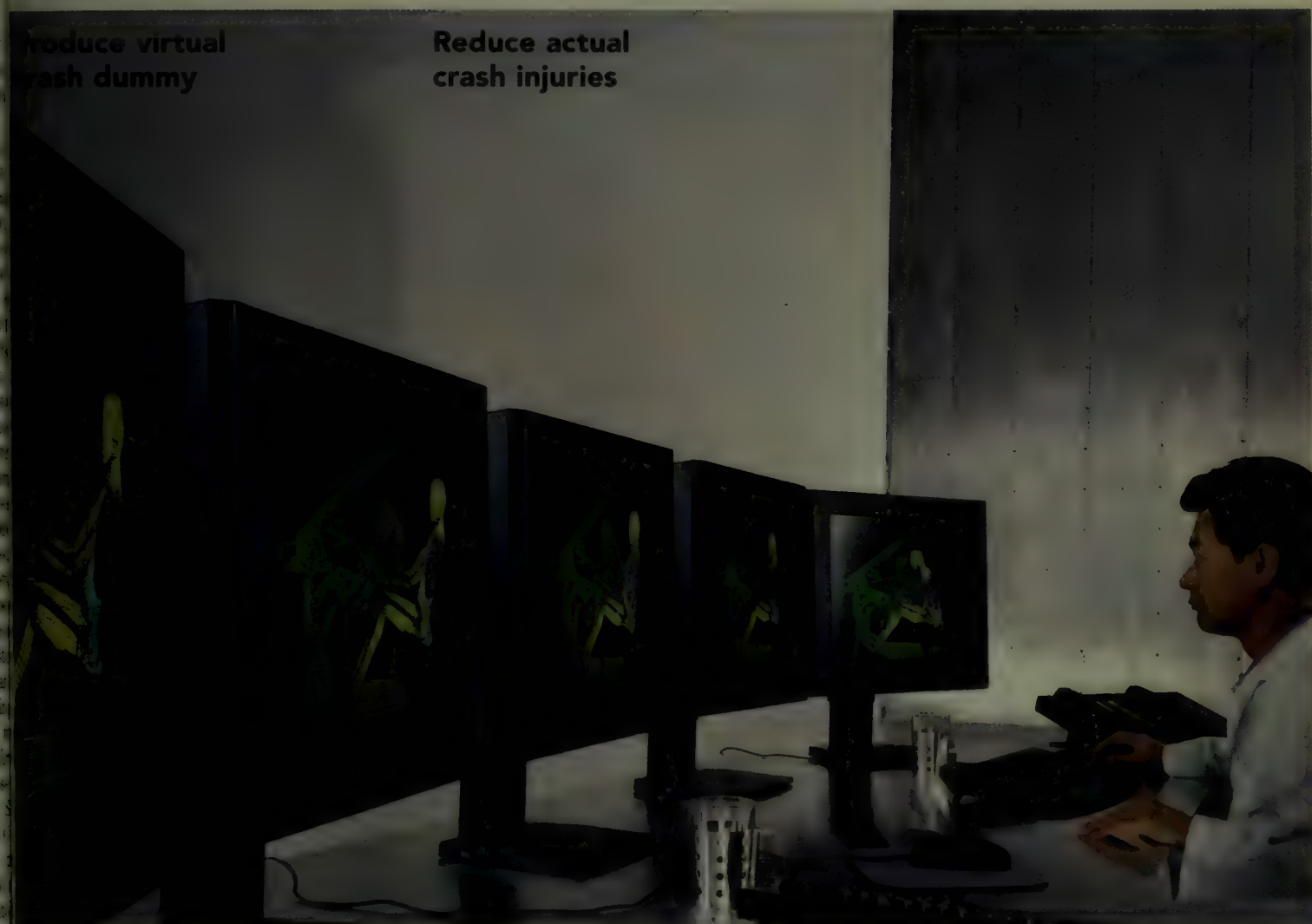
TODAY

Produce virtual
crash dummy

TOMORROW

Reduce actual
crash injuries

TOYOTA



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Agilent Technologies

dreams made real



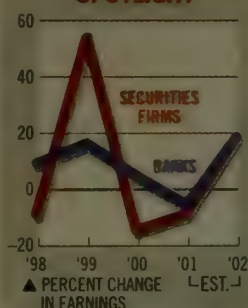
**BANKING &
SECURITIES 106**

INSURANCE 108

FINANCE

PROGNOSIS 2002

SPOTLIGHT



Data: Thomson Financial/First Call

POSITIVES

- Banks are far better capitalized than in the last downturn
- The Fed's rate cuts are providing plenty of cheap funding, which is helping to bolster loan margins

NEGATIVES

- Until the recovery takes off, credit losses will continue and underwriting activity will be depressed
- Wall Street is still overstaffed, meaning more downsizing

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 | 2002 EST.

\$143,000 | \$167,000

AVERAGE YEARLY CHANGE

4.1%

EMPLOYMENT

↑ = 250,000



GROWTH PROSPECTS

B

2002

OUTPUT \$579.6 BILLION

OUTPUT GROWTH 1.6%

1995-2001

AVG. YEARLY GROWTH 4.9%

Data: Economy.com

STILL TIGHTENING
THOSE BELTS

Outside of Tech Land, few sectors benefited from the economic boom of the 1990s as much as financial services. Wall Street's investment bankers raked in lush profits from underwriting a torrent of dot-com stock offerings. The fortunes of brokers and mutual-fund managers rose with each uptick in the Dow Jones industrial average. And the commercial banks enjoyed a lending boom fueled by Americans' unbridled willingness to borrow.

In 2001, the pendulum swung. First came the shock waves of the twin tech and telecom crashes. Then came the physical and financial trauma of the World Trade Center attack—and the deepening recession in its aftermath. In the once-lucrative underwriting and mergers arena, deal volume was down 56% through November and equity underwriting revenues were off by 25%. That has left Wall Street wrestling with high overheads, which continue to erode earnings. Pretax profits for New York Stock Exchange member firms plunged 51% in 2001, to \$28.2 billion, on a 20% decline in revenues, according to the Securities Industry Assn. Next year should be better, thanks in part to aggressive cost-cutting on the Street. Pretax profits are expected to recover 13%, to \$32.1 billion—better, but still a far cry from the industry's peak earnings in 2000 of \$58 billion.

In 2001, banks that take deposits—and that includes everything from neighborhood savings and loans to behemoths such as Citigroup—saw profits slide by 5%. And the news will worsen through the first half of this year. Bert Ely, president of Ely & Co., a Washington consultancy notes that the recent surge in corporate bankruptcies—including the \$50 billion filing by Enron Corp., the largest ever—may foreshadow a near-term rise in problem loans at banks. "I don't think we've seen the bottom of the credit cycle," says Ely. Against this backdrop, Andrew B. Collins, banking analyst at U.S. Bancorp Piper Jaffray, believes that loan charge-offs could rise in 2002 to 1.09% of all outstanding loans, vs. 0.97% in 2001. That's a significant swing for an industry that already survives on razor-thin margins.

It's not all bad news, though.

The Federal Reserve Bank's aggressive push of lower interest rates, which reduce the industry's borrowing costs, is helping to ease the banks' lending woes. Assuming a rebound in the second half, analysts surveyed by Thomson Financial/First Call expect bank earnings to rise by as much as 25% in 2002.

The worst may already be over for Wall Street. Some underwriters are hoping that the December rally in stocks is a sign that investors are returning to the game. Mark Nelly, head of U.S. equity capital markets at UBS Warburg, views the heavy number of stock offerings by biotech companies scheduled for January as a sign that "the appetite for risk is increasing, which bodes well for markets." Still, with the broader economy showing only tentative signs of recovery, Wall Street execs aren't ready to commit serious capital ahead of the upturn. Says Richard S. Fuld Jr., chairman of Lehman Brothers: "A lot of the world is calling for the beginning of the next bull market. I believe that I'm not managing the company to that. I believe there could be some more pain."

Just in case he's right, Wall Street is reeling in operations. Bonus payments, which in a year can be more than half of a banker's pay, fell by 30% in 2001, to an average of \$60,000 for each of the securities industry's 165,000 employees. And more than 30,000 investment bankers and other white-collar workers have already been laid off. Globally, firms will continue to scale back the sprawling

SALVE FOR THE ONCE-BURNED

For those who padded their nest egg with high-tech shares, the crash was especially terrifying. Now, many aging investors are shying away from high-risk stocks in favor of smaller, more stable returns. "Just as the '90s was the decade of equities, the next decade is likely to be the decade of seeking protection," says Charles M. Oliver, vice-chairman of Oliver, Wyman & Co., a financial industry consultant.

Increasingly, security-minded investors will be able to turn to more than just plain-vanilla bonds or bond funds. Wall Street's client base has been busy cooking up a new batch of investments designed to deliver returns that may be more modest, but that are more predictable and less volatile. In some instances, they'll even offer

as they erected during the go-go Nineties. Bank managers are following suit. Threatened by a shrinking loan market, their preferred antidote is cutting costs. Bank of America recently slashed 600 jobs, on top of 10,000 announced in mid-2000, while imposing fee restrictions and other measures. "We're focused on productivity gains and expense controls," says BofA CEO Kenneth D. Lewis.

Whether these sweeping cutbacks prove sufficient depends on the timing of the recovery. That could come as soon as this fall, some analysts believe, given the Fed's 11 rate cuts through 2001. The flood of liquidity has helped fuel a mortgage-refinance boom that should continue to boost banks' bottom lines. And the plunge in interest rates raising the market value of their holdings of bonds and other fixed-income investments, Collins notes. The 30 largest banks are now sitting on an average of \$291 million in unrealized securities gains in their portfolios.

Even if things don't pick up fast, the bank industry is far better prepared to weather downturn than in the early 1990s, when thousands of banks and thrifts failed. Banks are more geographically diversified now, so local shocks don't hurt as much. Stricter capital standards enacted after the thrift crisis also helped. These days, the 30 largest U.S. banks have about \$1.5 billion in excess capital, vs. a meager \$2 billion in 1990. Banks are getting better at managing their corporate loan portfolios, too. Thanks to the spread of syndicated lending, the industry's exposure to Enron is shared by some 50 banks and 30 insurers. Indeed, the banks' biggest weaknesses are likely to come from corporate borrowers,

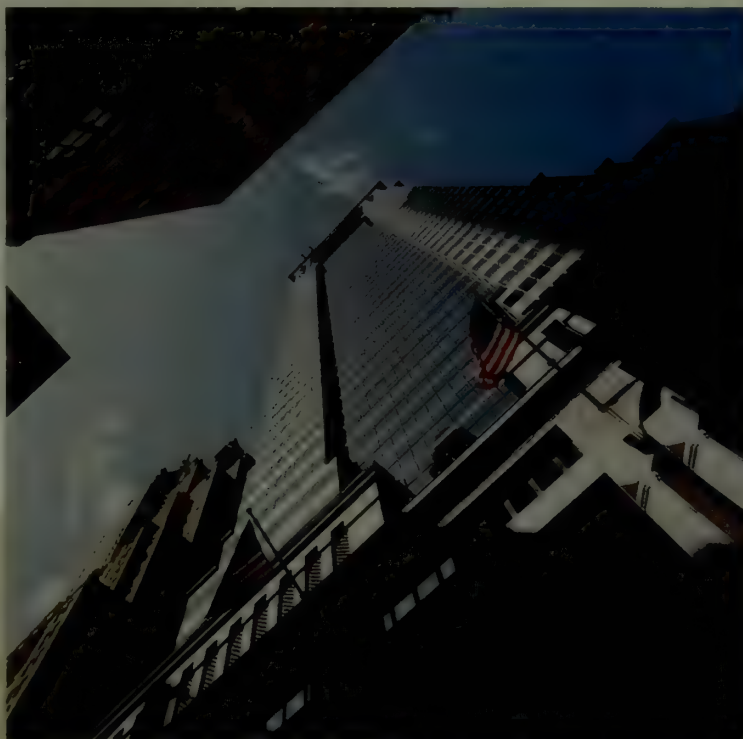
of big, equity-like gains with less risk to the principal. New products are starting to hit the market. American Skandia Life Insurance Corp., one of the nation's largest financial service providers, is offering the Guaranteed Return Fund, a variable annuity vehicle

that allows investors to chase growth in the equity markets while knowing that their principal is guaranteed after seven years. It works by investing an amount equivalent to the principal in fixed-income investments, such as Treasury bills and certificates of deposit, while the balance is put into a more aggressive vehicle with greater growth potential. Fidelity Group recently launched its second Pilgrim Principal Pro-

tection Fund, a so-called closed-end mutual fund. Like a stock, it trades on the exchange and can be bought and sold through a brokerage. But it guarantees the original principal at the end of five years. Experts believe that these offerings only scratch the surface of the products Wall Street's engineers will devise in coming years. How about a derivative that offers "overlay" of insurance across your entire investment portfolio? This might be just the salve for baby-boomer investors burned by the dot-com crash but still hoping for a comfortable retirement.

With so much of the industry on the knife's edge, any bank or brokerage that stumbles could quickly become takeover bait. "We have not run the course with bank consolidation," predicts Ely. Indeed, Merrill Lynch & Co. is rumored to be talking with Bank of America and others, and many believe the days may be numbered for regional banks and brokers. As the high wave of the 1990s recedes into history, bankers and brokers in 2002 will be watching for the riptide.

By Dean Foust in Atlanta, with Emily Thornton in New York



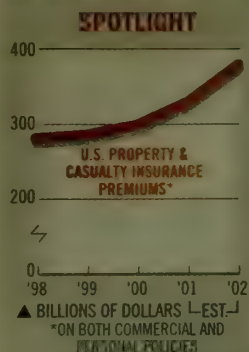
NEW DAY? *The worst may already be over for Wall Street*

tection Fund, a so-called closed-end mutual fund. Like a stock, it trades on the exchange and can be bought and sold through a brokerage. But it guarantees the original principal at the end of five years. Experts believe that these offerings only scratch the surface of the products Wall Street's engineers will devise in coming years. How about a derivative that offers "overlay" of insurance across your entire investment portfolio? This might be just the salve for baby-boomer investors burned by the dot-com crash but still hoping for a comfortable retirement.

"We're focused on productivity gains and expense controls"

By Dean Foust in Atlanta

PROGNOSIS 2002



Data: A.M. Best, Insurance Information Institute

POSITIVES

- The \$70 billion post-September 11 payouts will cause premiums—and insurers' revenues—to skyrocket
- New players are entering the reinsurance business

NEGATIVES

- Claims ate into the industry's 2001 asset base
- Legal actions over asbestos and toxic mold infestations are on the rise

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 2002 EST.

\$100,000 \$100,000

AVERAGE YEARLY CHANGE

0%

EMPLOYMENT

↑ = 250,000



2.3 MILLION

GROWTH PROSPECTS

B

2002

OUTPUT \$252.9 BILLION

OUTPUT GROWTH -0.3%

1998-2001

AVG. YEARLY GROWTH 0.1%

Data: Economy.com

SOARING RATES—AND REVENUE

After nearly a decade of vicious price-cutting, insurers started raising rates sharply in early 2001. Those hikes were triggered by eroding profit margins and a dramatic rise in claims and lawsuits relating to asbestos and toxic mold. But all that paled beside the September 11 attacks, which handed insurers their biggest challenge in decades. With U.S. companies expected to pay out half of the estimated \$70 billion needed to cover the property and lives lost in the tragedies in

New York, Washington, and Pennsylvania, the industry's \$100 billion worth of assets will be severely depleted.

The attacks thus laid the groundwork for phenomenally higher rates, almost across the board. "Before September 11, we were seeing a gradual increase in prices. Since then, it's been drastic," says Damian Testa, president of Kaye Insurance Associates, a New York broker. Even health-care insurance is expected to rise by 16% to 18% in 2002, following a 12% hike in 2001. Life insurance is the only line that won't see substantial price increases.

No doubt, price hikes will be hard on policyholders. From apartment owners in Manhattan to meat processors

in Iowa, everyone is facing 100% to 300% increases in the costs of property and business insurance policies, which insurers hope will lead to a strong rebound in profits. "Dramatically increasing premium rates are expected to have a positive effect on brokerage commissions and fees," says Patrick G. Ryan, CEO of insurance broker AON Corp. Positive indeed: Aon expects double-digit earnings growth, and Thomson Financial/First Call is forecasting that property and casualty earnings will surge 221% in 2002. This compares with a net decline of 54% last year. Earnings for managed health-care companies should rise 23%, compared with an 8% increase in 2001, according to Standard & Poor's.

Forecasts for prices and profits are, however, colored by an insurance safety net bill that stalled in the Senate in December. The House version called for industry to swallow the first \$10 billion in claims on future terrorist acts and for the federal government to pick up 90% of amounts in excess of that sum. That promise

had cast a warm glow on the business of "insurance"—policies that primary carriers could unload some of their big-claim risk. But that the bill has fallen through, terrorism coverage is in limbo. Until Congress revives legislation, reinsurers won't write new term policies. What's more, in the absence of full coverage, reinsurance rates on existing terrorism coverage will probably jump roughly 50%. That should boost Berkshire Hathaway's General Corp. Even Chubb Corp.'s smaller reinsurer

unit "will likely grow at double-digit rates," says Chubb's Dean R. O'Hare.

Meanwhile, serious problems that dogged the insurance sector before September 11 haven't gone away. Lawsuits over product liability, negligence, and discrimination increased at a 15% annual rate in the late 1990s. Rising in 2000, asbestos lawsuits reappeared with a vengeance. At least eight otherwiserupt companies filed for bankruptcy protection in 2001, one being named in asbestos cases. Standard & Poor's predicts insurers will have to strengthen reserves for asbestos settlements by at least \$30 billion.

Household mold is predicted to be an expensive problem

too. Thousands of claims and lawsuits relating to toxic mold in Texas and California homes cost insurers billions more. In May, a jury awarded Melinda Ballard and her family \$1 million for mold damage in their Drift Springs (Tex.) home. It ruled that Farmers Group Inc. failed to properly deal with Ballard's original claim. Farmers Insurance mold-related claims double, to more than \$1 billion in 2001, and is expected to increase its reserves in the anticipation of more payouts in the future.

Add to this litany some \$2.5 billion in payouts related to July's tropical storm Alvin and it's clear that insurers will start the year with sharply reduced balance sheets. The investment-portfolio cushions shriveled with the stock market collapse, and yields on their investments are declining because of low interest rates. Still, barring any new catastrophes, by midyear, skyrocketing rates should bring a break in the gloomy weather.

By Pallavi Gogoi in Chicago, with
McNamee in Washington



ASSESSING THE DAMAGE: Policyholders face severe price hikes



Kenneth
"Babyface" Edmonds



Destiny's Child



Boyz II Men



Tyrese

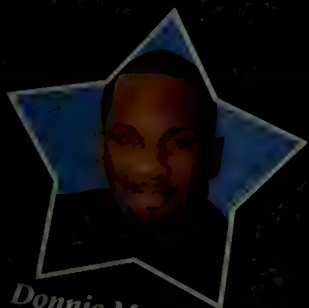


Lou Rawls



Yolanda Adams

TONIGHT THE STARS WILL DO MORE THAN
TWINKLE, THEY'LL LIGHT UP THE NIGHT.



Donnie McClurkin



A CELEBRATION of EDUCATIONAL EXCELLENCE
BENEFITING THE
UNITED NEGRO COLLEGE FUND



Boney James

Other Guest Stars:

- ★ Chanté Moore
- ★ Fred Hammond

Special Appearances by:

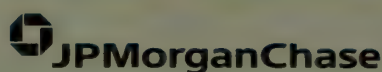
- ★ Bryant Gumbel
- ★ Vince Carter
- ★ Jason Terry
- ★ Maurice Greene

Co-Hosts:

- ★ Lou Rawls
- ★ Debbie Allen
- ★ Yolanda Adams
- ★ Bishop T.D. Jakes

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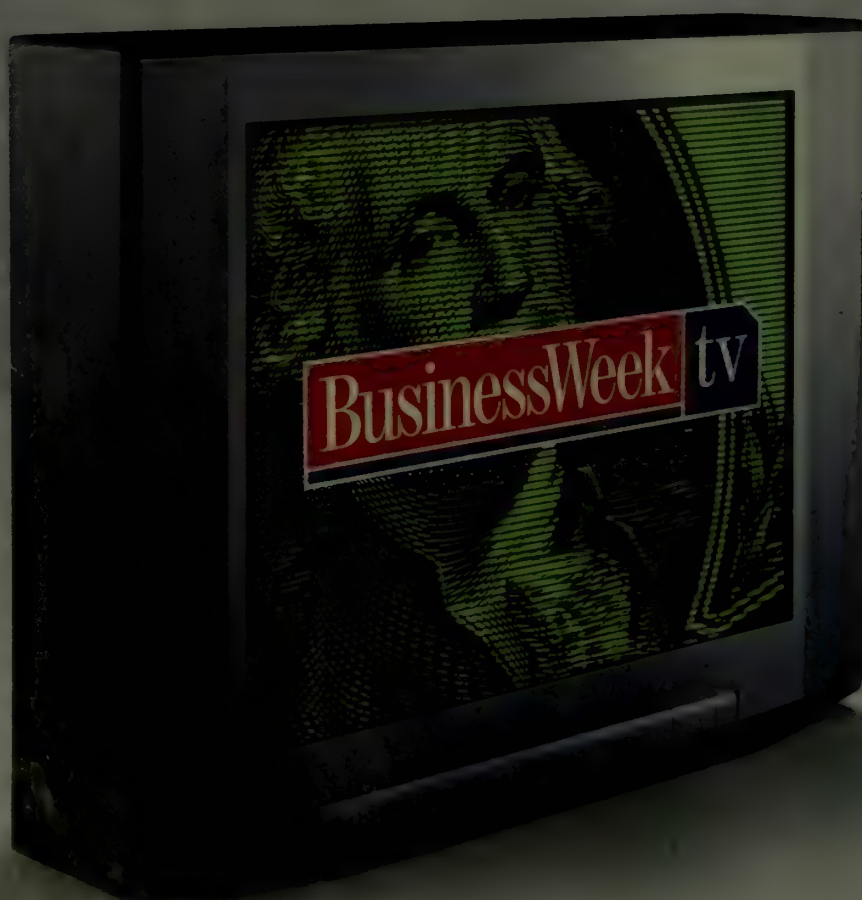
American Airlines



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LAURA SMITH

DRUGS 112

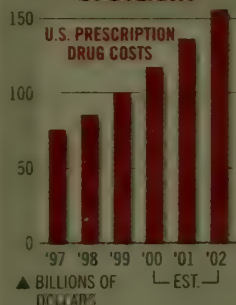
HEALTH CARE 114

AGRIBUSINESS 115

LIFE SCIENCES

PROGNOSIS 2002

SPOTLIGHT



Data: Centers for Medicare and Medicaid Services

POSITIVES

- A clutch of potential blockbusters is launching in 2002, including Crestor
- Margins for big drugmakers should continue to expand, thanks partly to mergers

NEGATIVES

- Generics will cut into sales of some big-selling drugs, including Prilosec
- A number of states and other big payers will push for deep drug discounts

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 | 2002 EST.

\$177,000 | \$201,000

AVERAGE YEARLY CHANGE

3.2%

EMPLOYMENT

↑ = 250,000

↑

0.3 MILLION

GROWTH PROSPECTS

A

2002

OUTPUT \$65.9 BILLION
OUTPUT GROWTH 2.1%

1998-2001

AVE. YEARLY GROWTH 7.2%

Data: Economy.com

HARDBALL IN WASHINGTON,
MERGERS IN BIOTECH

For drugmakers, 2002 will be a decent year, but it's unlikely to break any records. While government statistics show drug expenditures rising some 16% in 2001, the pace should cool a bit with the total hitting \$155 billion in 2002—a 14% increase.

Part of that slowdown will stem from the patent expirations of some major products, making room for cheaper, generic versions. The patent expirations are compounded by what Larry N. Feinberg, managing partner for health-care hedge fund Oracle Partners LP, describes as “a lackluster new product pipeline for the next few years.”

That's not to say some new products won't make a splash. In late 2001, Eli Lilly & Co. rolled out a new drug called Xigris to treat sepsis, the deadly damage caused by the body's overwhelming response to infection. The drug could rack up \$1 billion in sales by 2005, according to SG Cowen Securities Corp. Another eagerly awaited drug is Crestor, the latest cholesterol-lowering agent, from AstraZeneca PLC. And two new painkillers, part of the hot new class of drugs called Cox-2 inhibitors, could be big sellers in 2002. Pharmacia Corp. will launch Bextra in early 2002, while Merck & Co. is likely to follow with Arcoxia later in the year. Both drugs could reach \$1 billion or more in annual sales within four years.

While a lot is riding on these product launches, the industry has just as much at stake in its ongoing political battles. The biggest threat is the growing movement by some states, such as Michigan and Florida, to cut their ballooning prescription drug bill for programs such as Medicaid. These states have passed laws or taken other steps aimed at wrestling big discounts from major pharmaceutical companies. The drug industry's trade group has already challenged some of these measures in court, but more states are sure to push such programs as the recession puts additional strain on budgets. “States are getting much more aggressive in the types of rebate concessions they are demanding,” says Robert A. Freeman, senior director of public policy at AstraZeneca.

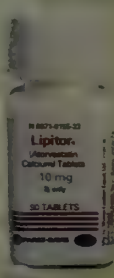
The risks drugmakers face in

Washington, while not as immediate, are certainly real. In 2002, Congress must renew 1992 law that created an industry-funded approval system for the Food & Drug Administration. Political experts figure generic makers and others will try to attach additional legislation to the bill aimed at closing holes that now let drug companies delay generic versions of big-selling products. That could gain momentum when the Federal Commission releases a report in the spring on whether certain industry practices have appropriately delayed generic competition.

Still, most say that debate—as well as discussion of a Medicare prescription drug benefit—may not lead to legislative action. In the elections, 2002 will be a politically charged year,” says Eli Lilly Chairman and CEO Stephen Taurel. “I doubt we'll get to the level-headed compromise that is needed on these issues.”

Going into the new year, the industry may actually have extra leverage in Washington, thanks to its new role in fighting bioterrorism. In the wake of the anthrax attacks last fall, drug makers offered Uncle Sam everything from antibiotics to extended access to biomedical researchers and labs. But analysts say the new government contract for large-scale production of a smallpox vaccine, which was at a lower price than Wall Street expected, shows how hard the government will push to keep costs down. Says Raymond V. Gilmartin, chairman and CEO of Merck & Co.: “I don't think [these contracts] will significantly change the growth rate of companies” in the industry.

TAKING AIM AT A PFIZER HIT

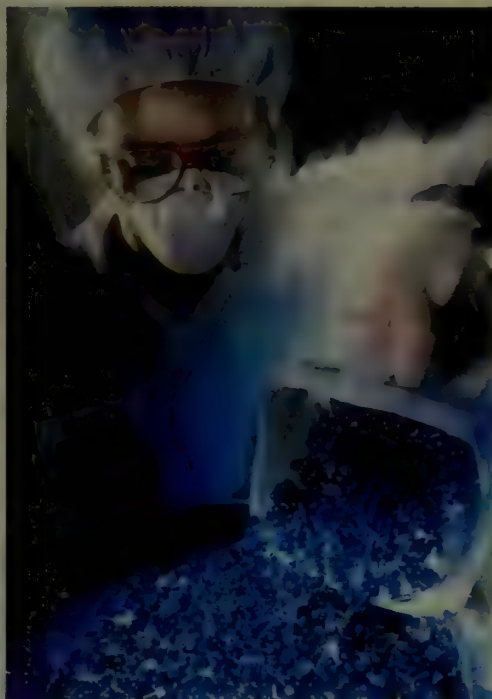


It's hard to underestimate the importance of Lipitor Inc. The cholesterol-lowering blockbuster—one of a class of drugs called statins—brings in \$6.5 billion in annual revenues. That makes it the world's top-selling drug, and it's set to become the world's first \$10 billion drug. It was launched in 1997 by Warner-Lambert, which Pfizer acquired in 2000 specifically to get its hands on Lipitor.

Now, a new statin from AstraZeneca PLC is likely to enter a fierce marketing battle. The drug, called Crestor, could receive U.S. Food and Drug Administration approval as early as this summer. Seven

much larger impact likely to be felt from consolidation. The past saw continued dealing, led by Bristol-Myers Squibb Co.'s \$7.8 billion purchase of Abbott's pharma operations. Companies with thick new-product lineups and midsize operators need to bulk up their research and marketing to do more deals. Schering-Plough is a possible bet. It's dwarfed in size by giants like Pfizer and GlaxoSmithKline and has been dogged recently by regulatory woes related to its manufacturing processes. "Clinical trials are so expensive now, and getting a physician's attention is very difficult," says Ben Bonifant, vice president at Mercer Management Consulting Inc. "It's getting hard to be a midsize player."

The same pressures are triggering a wave of dealmaking in biotech. Amgen struck a \$1.6 billion deal in December to buy biotech star Immunex in order to add Immunex' rheumatoid arthritis drug Enbrel to its lineup. There are plenty of other small biotechs with pipelines that could attract suitors. According to Samuel W. Murphy III, senior securities analyst at American Express Financial Advisors, biotech companies over the next 12 to 18 months could launch 10 products with potential annual sales of \$500 million to \$1 billion each. Among the possible blockbusters are a new cancer drug from Idec Pharmaceuticals Corp. and the just-launched anemia drug Aranesp from Amgen. "Size and critical mass are the



PRICY PILLS: The cost of clinical trials is forcing more companies into alliances

products. The most notable move in 2001 was initiated, once again, by Bristol-Myers, which is determined to solidify its lead in the cancer market. Bristol made a \$1 billion investment in ImClone Systems Inc. and agreed to pay another \$1 billion for the right to co-promote the company's promising new cancer compound.

Mergers—and liquidations—are also likely to rise among companies that supply analytical tools and other technology to Big Pharma. Some of these suppliers may face a tough 2002 as their technology becomes obsolete, says Lloyd S. Kurtz, health-care analyst at money manager Harris Bretall Sullivan & Smith. Yet another reason pharmaceutical and biotechnology players will find 2002 a year of great opportunity—and great challenges.

By Amy Barrett in Philadelphia

key drivers of these deals," says Viren Mehta, a pharmaceutical analyst at Mehta Partners, of the recent merger wave.

For biotech players that want to remain independent, dealmaking will likely take the form of alliances and licensing arrangements. According to biotech consulting firm Recombinant Capital, biotechs saw \$1.9 billion flow into their coffers in the first three quarters of 2001 from such alliances, up 14% from the same period in 2000. Much of the activity stemmed from deals that allow access to new technologies in emerging fields like genomics. However, big pharmaceutical companies have been turning to biotech to fill their pipelines with actual

Michigan, Florida, and other states are taking steps to wrestle big discounts from major drug companies

ing data released at the March meeting of the American Cardiology, have shown Crestor may be even more potent

no one is predicting that Crestor will knock Lipitor off its No. 1 statin. That's partly because physicians are already familiar with Pfizer's drug, and partly due to the financial muscle behind the product. "Pfizer has arguably the most effective marketing program in the world," says Lloyd S. Kurtz, health-care analyst at Harris Bretall Sullivan & Smith, which holds about 4.5 million Pfizer shares or money's on Lipitor."

Working in Pfizer's favor is the August, 2001, withdrawal of the drug from the market. The drug was pulled by its manufacturer after reports that a number of patients died from a rare

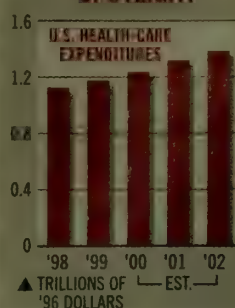
muscle side effect. That may happen with Lipitor and other statins, too—but much less frequently. AstraZeneca says that its studies show that Crestor's safety profile is in line with other statins still on the market. But Pfizer may be able to convince some doctors that they are better off using a drug they know well, rather than trying a new statin that could have unknown problems. Says Dr. Rob Scott, vice-president of Pfizer's cardiovascular and metabolic group: "A new drug will have to show it is not another Baycol."

Pfizer, however, has created a bit of an opening for AstraZeneca. It snatched the top spot from Merck & Co.'s Zocor by hammering home the message that Lipitor was more effective. Now, doctors may be more receptive to AstraZeneca's message that Crestor is more potent still. Expect a marketing blitz from both sides.

By Amy Barrett

PROGNOSIS 2002

SPOTLIGHT



Data: J.P. Morgan Securities Inc.

POSITIVES

- Health insurers are successfully raising rates to outpace rising costs
- Hospitals have adjusted to the massive cuts in Medicare reimbursements

NEGATIVES

- A severe nursing shortage is driving up hospital labor costs
- Employees are shouldering more health-care burdens as insurers raise premiums

PRODUCTIVITY

VALUE ADDED PER EMPLOYEE, '01 DOLLARS

1998 2002 EST.

\$52,000 \$46,000

AVERAGE YEARLY CHANGE

-1.8%

EMPLOYMENT

▲ = 250,000



13.9 MILLION

GROWTH PROSPECTS

C

2002

OUTPUT \$65.4 BILLION
OUTPUT GROWTH 0.3%

1990-2001

AVG. YEARLY GROWTH 0.3%

Data: Economy.com

COSTS WILL STAY FEVERISH

There is one issue that overshadows all others in the health-care industry, whether you are a provider of services or a payer: Costs are going up fast. Expensive new drugs and surgical procedures are proliferating, and an aging population is using more of them. On top of that, hospitals and insurers will have to start complying with elaborate new patient-privacy laws. Together, these factors all but guarantee that health care will be more expensive in 2002.

The impact of rising costs, however, affects payers and providers very differently. Hospitals will continue their struggle to stay afloat in a sea of red ink, just as they did in 2001. Some insurers will struggle, too, but they will be able to raise rates to compensate. One way or another, the rest of us will foot the bill—and it won't be negligible. The amount the U.S. spends on health care is expected to rise to \$1.37 trillion in 2002. That's equal to 13.9%

of the gross domestic product—up from \$1.3 trillion, or 13.4% in 2001, according to J.P. Morgan Securities Inc.

Employers will pick up a bigger share of the increases. An annual survey of large companies by the consulting firm Towers Perrin indicates that health-plan costs will increase an average of 14% in 2002—the largest annual hike since the survey started a decade ago, and the third consecutive year of double-digit increases. Bill McGeever, health industry analyst at UBS Warburg Ltd., says that unless there is a major change in the system, “we are going to be stuck with more and more resources going to health care.”

Hospitals have been adapting to a world of dwindling resources ever since Congress passed the Balanced Budget Amendment (BBA) in 1997. That cut Medicare payments to hospitals by \$100 billion over five years. By now, say analysts, most institutions have managed to adjust to that huge income reduction, helped along by some \$50 billion in BBA relief from Congress over the last four years. As a result, says analyst Bruce Gordon of Moody's Investors Services, the financial outlook for hospital bond issues seems to be stabilizing. “The

number of [credit] downgrades exceeded grades by 3 to 1 through the first nine months [of 2001], but that's an improvement from 1 in 2000,” he says.

Still, sharply rising labor costs will be a burden for hospitals this year. A dearth of new and skilled lab technicians is forcing hospitals to shell out more money to hang on to staff. Whether that or lose money by leaving beds empty. And hospitals have plenty of other troubles. An upturn in pharmaceutical drug costs remains a challenge, along with greater scrutiny

health-care cost governments and corporations, and the need to invest in long-delayed capital improvements. The bottom line, says Lewis Reder, director of Capgemini Ernst & Young's health practice: “Clients are very challenged financially.”

Not so for health insurers. Anticipated rate hikes should more than cover their rising costs. In 2001, insured and managed-care companies reaped profits



CRITICAL: Hospitals will have to pay more to keep highly trained staff from leaving

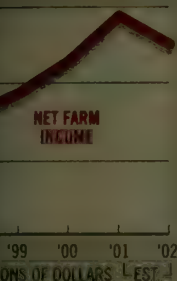
from insurance premiums of 12% to 15%. They should achieve the same high levels in 2002, estimates J.P. Morgan, thanks to a combination of higher rates, higher co-payments, and higher deductibles. It's not just top-tier companies such as CIGNA, Wellpoint Health Network and UnitedHealth Group that will be turning in strong results. Oxford Health Plans, Humana, and several Blue Cross & Shield plans recovered in 2001 and should prosper in 2002, predict Morgan analysts.

So far, says Warburg's McGeever, there's little evidence that employers are resisting higher rates. That could be because, in the past, they have often been able to pass on costs along to employees. Small employers took this tack in 2001, and a national survey of employer-sponsored health plans by consulting firm William M. Mercer Cos. found that large employers intend to follow. Mercer estimates that the average per-employee cost for health care, \$5,162 in 2001, will increase by 12.8% in 2002. It seems year after year, there is a third sure thing for U.S. citizens besides death and taxes: rising health costs.

By Catherine Arnst in New

PROGNOSIS 2002

SPOTLIGHT



Data: USDA

POSITIVES

U.S. farm exports will surge by \$2 billion now that China has entered the WTO and lowered its trade barriers

Corn farmers will benefit from increasing demand for ethanol

NEGATIVES

Safety worries over genetically modified grain limit overseas sales

Beef demand in Japan may plunge after discovery of mad cow disease

PRODUCTIVITY

VALUE ADDED PER EMPLOYEE '01 DOLLARS

1998 2002 EST.

\$80,000 \$96,000

AVERAGE YEARLY CHANGE

4.6%

EMPLOYMENT

↑ = 250,000

1.1 MILLION

GROWTH PROSPECTS

B

2002

PUT \$109.9 BILLION

PUT GROWTH 2.1%

1998-2001

YEARLY GROWTH 2.9%

Data: Economy.com

BETTER, BUT NO BUMPER YEAR

In 2001, U.S. prices for cotton, rice, soybeans, and other farm commodities languished at historic lows. So despite big harvests, revenues shrank across the agricultural sector, sparing neither farmers nor equipment makers. This year will be better, but just a little. Prices won't rebound much because more countries are trying to boost exports of farm products to combat the global economic slowdown. "We've got a lot of competition in the world," says Keith Collins, chief economist for the U.S. Agriculture Dept.

The \$206 billion agribusiness sector could be in for a few pleasant surprises, however. Corn prices may firm up faster than expected because many farmers have switched from corn to soybeans, a crop that carries a bigger subsidy. As a result, corn stockpiles are now being depleted to meet demand. Producers also stand to get a welcome increase in price supports if a new farm bill is enacted. And farmers are cheered by the prospect of huge new markets in China.

Nonetheless, such bright spots are the exception. Even for soybeans, one of America's main cash crops, prices will linger at all-time lows. To be sure, more soybean meal protein is being fed to animals in Europe and Asia amidst ongoing concerns about mad cow disease. Big soybean crushers such as Archer Daniels Midland, Bunge, and Cargill are going after that market. But Latin American soybean farmers, who have steadily gained market share at the expense of U.S. producers, will likely satisfy much of the demand. Agriculture's Collins wonders whether subsidies are sustainable and whether they "really help American agriculture meet the emerging competition."

Prospects in the \$42 billion cattle industry are hardly any better. Although strong demand and tight supplies in the cattle market sparked a 10% increase in retail beef prices at the beginning of 2001, demand fell as the economy weakened—then sank even further after the terrorist attacks of September. Mad cow disease is another drag on consumption. U.S. herds have been spared so far, but a handful of cases have surfaced in Japan—the largest foreign market for U.S. beef. Charles D. Lambert, chief economist with the National Cat-

tlemen's Beef Assn., worries about continued weakness in 2002.

As the farm economy sputters, equipment manufacturers such as Deere & Co. anticipate another year of sluggish sales. Deere reported losses of \$64 million for its fiscal year ended Oct. 31. Overall, sales in the \$10 billion North American farm-equipment industry may fall as much as 5% from 2001 levels. One factor dampening demand is uncertainty over the next farm bill. The 1996 bill expires this year, and lawmakers are wrangling over a new one. "If you don't know what's coming, you don't make capital investments like you would if commodity prices alone drove that decision," says Mogens C. Bay, chairman of Valmont Industries, a maker of irrigation systems in Omaha.

On the bright side, China's entry into the World Trade Organization is creating opportunities for embattled U.S. farmers. John W. Skorburg, an economist at the American Farm Bureau Federation, says that Chinese imports of soybeans could rise steeply—from about 13 million metric tons this year, to 15 million by 2005. By then, he also expects China to turn from an exporter to an importer of corn. Rising incomes in China should stimulate demand for wheat, beef, and poultry as well, Skorburg says. But that's the future. In 2002, farm exports are likely to grow only slightly, to \$54.5 billion.

Genetically modified foods remain a wild card. American farmers are planting more bio-engineered seeds than ever before, and the Europeans are protesting less, says Tim Stocker, head of regulatory affairs in Europe for seed company Pioneer Hi-Bred International Inc. Now, there's new hope within U.S. agribusiness that the European Union will move forward on proposed food-labeling laws that would tacitly recognize the safety of engineered foods. Wider acceptance there—or in Asia or Latin America—could spark new growth in U.S. exports.

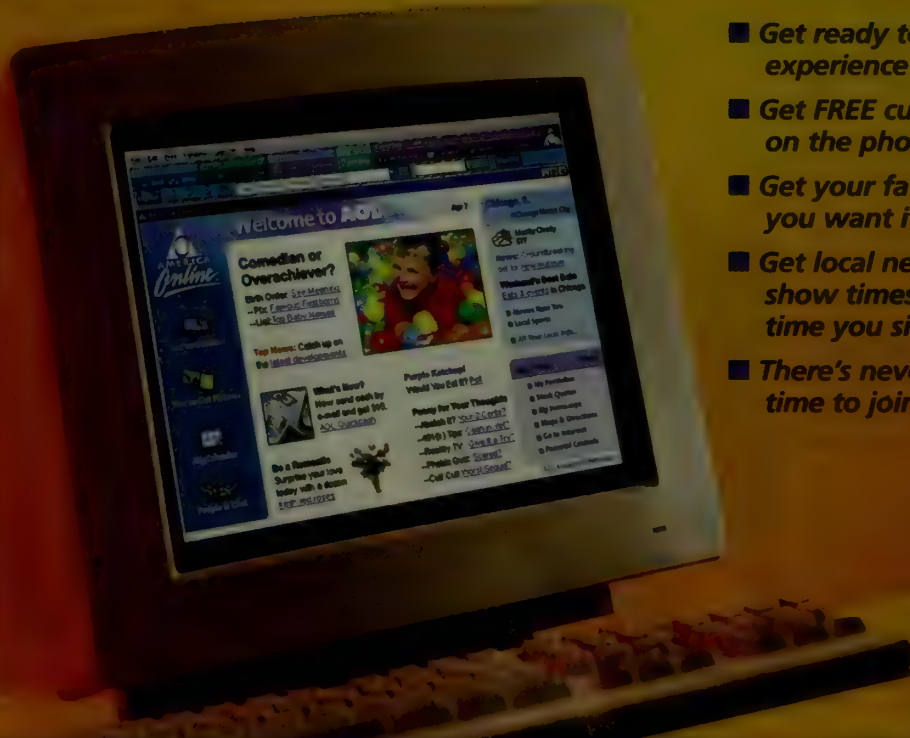
The big wait-and-see issues for this year will be the farm bill and the recession. A recovery, or some well-placed subsidies, could go a long way in dispelling the gloom hanging over U.S. farms.

By Julie Forster in Chicago



ROUGH RIDE: Despite large harvests, many farmers won't enjoy big revenues

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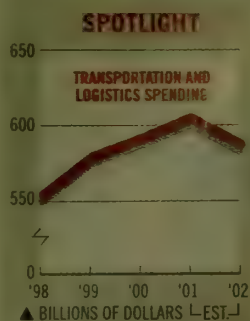
TRANSPORTATION 118

RETAIL 119

FOOD 120

DISTRIBUTION

PROGNOSIS 2002



Data: DRI-WEFA

POSITIVES

- Internet-powered logistics services are fast developing into a major new line of business
- Falling fuel prices are improving the industry's bottom line

NEGATIVES

- A weak economy crimps demand for transportation
- Small and midsize companies are struggling to compete with big national carriers

PRODUCTIVITY

ECONOMIC VALUE ADDED PER EMPLOYEE, '01 DOLLARS

1998	2002 EST.
\$85,000	\$93,000

AVERAGE YEARLY CHANGE

2.1%

EMPLOYMENT

↑ = 250,000



10.0 MILLION

GROWTH PROSPECTS

B

2002

OUTPUT **\$927.9 BILLION**
OUTPUT GROWTH **1.6%**

1998-2001

AVE. YEARLY GROWTH **2.9%**

Data: Economy.com

A LONG HAUL TO RECOVERY?

TheraSense Inc.'s founders concede they know more about the chemistry of diagnostics than logistics. That's why they decided to give UPS Logistics the job of distributing the new FreeStyle test—a painless method for diabetics to check their blood-sugar levels. The logistics arm of United Parcel Service Inc. harnesses Internet technologies to track, stock, and ship the kits from a warehouse in Delaware—3,000 miles from TheraSense's headquarters in Alameda, Calif. "That frees us to focus on electrochemistry," says Tae Andrews, TheraSense's vice-president for sales and marketing.

With just \$60 million in sales, TheraSense is a tiny blip in the immense world of transportation. But its arrangement with UPS represents a big trend. Despite the recession, Internet-driven logistics continue to remake the

way in which goods are stored and moved around the globe. Indeed, this is the one segment of the industry that's predicted to grow strongly in 2002 and beyond. Revenue in this segment is expected to nearly double in the next five years, to \$100 billion, according to a recent report by Lazard Frères & Co.

For transportation as a whole, however, revenue will slide by 2.8%, to \$587 billion in 2002, from \$604 billion last year. Industry execs are particularly bearish about prospects through the first quarter. It's clear that manufacturers will be shipping fewer products to stores, that retailers will be transporting fewer goods to customers, and so on. That, in turn, is hurting purchases of trucks, planes, and railcars. "There are going to be a lot of anxious moments in the boardroom about capital spending this year," says Matthew K. Rose, CEO of Burlington Northern Santa Fe Corp., the largest U.S. railfreight operator.

Still, come the second half of 2002, transportation demand is expected to get into gear and roll on for the next several years. "When volume rebounds, we'll see a strong return of earnings, given how efficient transportation companies have become," says Lazard's transportation analyst, James L. Winchester.

Until then, every shipper is in the slow lane. "When the economy slows, so does the transportation industry," says Hugh L. Randall,

vice-president of Mercer Management Consulting Inc. Trucks, the biggest domestic carriers, are in especially bad shape. Yellow, the nation's largest trucker, has seen its daily volume of 70,000 loads fall 13% in the past 14 months—the lowest level in 15 years. Even harder hit are local and regional carriers. Nearly 5,000 of them have closed or for bankruptcy in the past two years, according to a study by A.G. Edwards & Sons Inc. Looming on the horizon is new competition in the form of low-price Mexican truckers, who are expected to gain U.S. entry for the first time under legislation that probably will be approved early this year.

Truckers aren't suffering alone—rail and airfreight companies are hurting, too. Analysts expect revenues for the nation's freight railroads to grow 1% to 2% at



ON THE MOVE: Strong growth is expected for shippers who use Internet-driven logistics

this year, and carriers will continue to have trouble containing prices. Ocean shippers are worse off. Seafright capacity will grow 13% to 14%, but demand lags behind at just 6% to 8%, according to Lazard. The combination translates into falling prices. Says Winchester: "There are many boats in all

tors, and the industry is awash in capacity. Domestic airfreight faces a similar problem, and carriers have already slashed freight capacity by 20% since September.

While competition is whittling down the demand for cargo space, demand for logistics services is climbing steeply. And 2002 is expected to be the best year yet for this young segment. "That's when we'll really begin to harvest the investment in logistics over the past decade," says UPS' incoming chairman, Michael L. Esposito, who expects his logistics business to continue growing in the double digits.

The logistics boom will spread to rail, sea, and road transporters too. "We're offering one-stop shopping—everything from one-day delivery to inventory management," says Yellow Freight's William D. Zollars. "I'm constantly reminding our people that our competitors today are UPSs and FedExes of the world." Logistics, it seems, is transforming a hardworking service into a service-focused, high-tech one, as we

By Charles Haddad in Atlanta

GNOSIS 2002

SPOTLIGHT

U.S. RETAIL SALES

'99 '00 '01 '02
BILLIONS OF DOLLARS (EST.)

Data: Bank of Tokyo-Mitsubishi

POSITIVES

Discount and value-oriented retailers will be leading the sector. Confident buyers will boost retail prospects in second half.

NEGATIVES

More struggles for mall-based stores—specialty retailers and department stores in particular. Retailers will have less count leeway as stock prices run down.

PRODUCTIVITY

ECONOMIC VALUE ADDED PER EMPLOYEE, '01 DOLLARS

1999 2002 EST.

43,000 \$45,000

PERCENT YEARLY CHANGE

1.2%

EMPLOYMENT

↑ = 250,000



9.2 MILLION

GROWTH PROSPECTS

C

2002

GDP \$416.1 BILLION

GDP GROWTH 0.1%

1999-2001

YEARLY GROWTH 2.6%

Data: Economy.com

DISCOUNTERS GET THEIR DAY

Even before September 11, analysts were expecting the worst results in a decade for the retail sector. After the terrorist attacks, traffic to stores dwindled to a trickle. This ghostliness will continue to haunt 2002. But by next autumn—barring any more mayhem—retail sales should pick up, in the view of many analysts, consultants, and retailers. Nationwide, same-store sales in the U.S. could grow by 3% to 5%, says Jay Scansaroli, managing partner for Andersen's retail advisory services, in contrast to what he thinks was a single-digit decline in the past 12 months. "This year will be a brighter year," he says.

Because retail sales hinge on consumer spending, a real reversal of fortune for retail will require an economic recovery strong enough to raise consumer confidence. Some store owners consider that wishful thinking. "We're planning our business as if the economy won't improve over the next six months," says Eileen Dunn, vice-president of investor relations for Office Depot Inc. The company will open 40 stores in North America in 2002, the same as last year—down from 63 in 2000.

Retail bulls see lots of reasons why sales should eventually perk up. Liquidity pumped into the economy by the Fed's 11 interest-rate reductions last year, tax cuts, and extra income in consumers' pockets from falling gas prices will all make it easier for people to hit the shops. "The third and fourth quarters of 2002 could be surprisingly positive," says Gary Stibel, principal of the New England Consulting Group, a marketing firm.

Sales growth won't solve all the problems, however. To improve the bottom line, retailers will have to keep an eye on inventory and other expenses. Expect retailers to scale back expansions, slash advertising, and run leaner inventories. The latter step, in particular, should eliminate some of the most damaging forms of discounting and in turn boost sagging margins. Lazard Frères & Co. expects operating margins for the nine largest specialty stores—including Abercrombie & Fitch, Gap, and Talbots—to grow to 10.4%, from 9.3% in 2001. That's an improvement, but still below the 1999 peak of 13.4%.

Even as the economy picks up, consumers will try to stretch their dollars. So discounters and value-oriented retailers such as Wal-Mart Stores Inc. and Target Corp.'s Target Stores will continue to take market share away from mall-based department stores and specialty stores, which retail analyst Mark Mandel of SunTrust Robinson Humphrey describes as "the biggest losers." All of the major department-store chains will remain under pressure and will work hard to get rid of excessive inventory. "The discounters will continue to do abnormally well, regardless of whether the economy continues to suffer or turns around," says New England Consulting Group's Stibel.

One of the winners could be Family Dollar Stores Inc., which targets low- and middle-income families. The 4,247-store chain is moving ahead with aggressive plans to open 525 new stores—up from 502 last year. Executive Vice-President George R. Mahoney Jr. expects 10% growth in earnings and 5% growth in same-store sales, driven mostly by the sale of such basic consumables as detergents and paper napkins. "We expect to continue not only growing but growing profitably," says Mahoney.

Specialty retailers, on the other hand, will focus more on improving productivity at existing stores and less on increasing their store base. Specialty apparel stores will grow their square footage by 7.3% in 2002, down from 8.8% last year, estimates Lazard analyst Todd Slater. Overexpanded chains, such as Ann Taylor Stores Corp., will see their growth decelerate significantly. The women's apparel retailer has allocated only \$47 million to capital expenditures, down 43% from last year, as it cuts back planned new-store openings at its Ann Taylor stores division from 20 to 7.

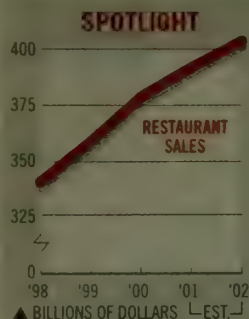
Analysts expect specialty outfits that execute well, such as American Eagle Outfitters Inc., to do better than most. Ditto for women's apparel chains that cater to baby boomers, such as Talbots Inc., which is successfully expanding its brand into large sizes, petites, and accessories. Those retailers that manage to differentiate themselves—on value, not just on price—will emerge the winners.

By Aixa M. Pascual in Atlanta



SALE FEVER: Even as a recovery kicks in, consumers will be looking for bargains

PROGNOSIS 2002



Data: National Restaurant Association

POSITIVES

- Manufacturers push convenience foods like precooked ground beef and tuna-in-a-pouch
- Free-range chickens, no-pesticide produce, and organic foods are soaring

NEGATIVES

- Traditional grocery stores will be hit by the recession: Sales will grow by little more than 2%
- Restaurant sales growth slows as consumers cocoon more

PRODUCTIVITY

ECONOMIC VALUE ADDED PER EMPLOYEE, '01 DOLLARS

1998 2002 EST.

\$40,000 \$41,000

AVERAGE YEARLY CHANGE

0.9%

EMPLOYMENT

↑ = 250,000



14.5 MILLION

GROWTH PROSPECTS

B

2002

OUTPUT \$591.6 BILLION

OUTPUT GROWTH 1.3%

1996-2001

AVE. YEARLY GROWTH 2.0%

Data: Economy.com

HUNGRY FOR CONVENIENCE

Americans seem to have a bottomless appetite for eating at restaurants, coffee shops, juice bars, and vending machines. Last year, 46% of family food dollars, or about \$392 billion, were spent on meals and snacks outside the home. The tally might have been a little higher had the economy not tanked. Still, some food-industry pundits take the long view: By 2010, predicts the National Restaurant Assn., Americans' obsession with convenience will spur them to spend 53% of their food budgets away from their kitchens.

This year, while analysts are far from bullish, they are expecting a slight increase in restaurant sales. Trendy, upscale restaurants won't be as packed as they were in years past, mainly because the soft economy will continue to discourage their patrons, says B. Hudson Riehle, a senior vice-president at the restaurant association. But sales at fast-food joints will more than offset any sluggishness at the top end, he predicts. So despite the economic malaise, the restaurateurs expect to post a 3.9% increase in business this year, to \$408 billion. Owners and managers remain worried, however, because that growth rate lags the

5.4% growth of 2000. When the association surveyed its members in recent years about major challenges, quality of labor always topped the list. Now, says Riehle, "it's the economy and maintaining business."

Slow growth is bound to have repercussions for restaurant suppliers. Some of the big outlets are already getting slammed, including Tyson Foods, Pillsbury (now part of General Mills Inc.), and H.J. Heinz, says Robert S. Goldin, executive vice-president of Technomic, a food-industry consultant. Goldin predicts that suppliers will grow at a mere 1% to 2%. However, most of those companies have much larger grocery retail businesses, which will compensate to some degree.

Nobody in the supermarket industry expects much rebound business from restaurants. "People aren't going to go back to cooking the way their grandparents did," says Michael J. Sansolo, a senior vice-president at Food Marketing Institute, a trade group. But he does see the slowdown as an opportunity for member su-

permarkets to fine-tune their appeals to shoppers—and perhaps bolster their notorious margins as well. Give shoppers a choice between lower prices or more convenience, Sansolo, and convenience will win every time.

Harried shoppers certainly seem to like the one-stop approach. Sansolo notes that if it is among the 3% of supermarkets with self-checkout pumps, "half of the shoppers will use the station because of the convenience factor." Other convenience technology that's sweeping stores and shoppers by storm is self-checkout lanes. Already used by an estimated 20% of grocery stores, self-scanning is a win-win innovation. It lets shoppers bypass the cashier and saves the store money at the same time.

Convenience has been a strength of



FAST FOOD: With self-service scanners, shoppers save time, and stores save money

aged-foods products for decades. To carry on with today's generation, food producers are bringing "almost food" products even into homes without microwave ovens. For example, size meals will go from the freezer, to the table, and to the table in little as 10 minutes. The kids still get impatient, parents can't out some distractions, novelties this year include toast decorated with blue-and-pink margarine.

Food and restaurant execs are keeping their fingers crossed that terrorists will stay away from food. After September 11, restaurant sales took a noticeable hit—but if the supply were attacked, the outcome could even worse. William T. Hawks, an Agriculture Dept. Under Secretary, says precaution is being taken. Already, the number of food inspectors at U.S. ports of entry has increased by nearly 40%, for example. But imported foods flow through so many ports that security could never be absolutely guaranteed. By the same token, a supply network as complex would be difficult for anyone to disrupt significantly. Still, imagine the reaction if food laced with botulism—not to mention anthrax—turned up in a few supermarkets.

That hypothetical threat seems not to be worrying shoppers and diners—which is good with food producers and restaurants. Without terrorism, the challenges for the industry this year will be steep.

By Julie Forster in Chicago



LAURA SMITH

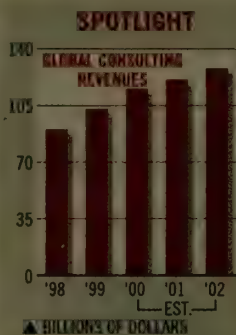
**PROFESSIONAL
SERVICES 122**

EDUCATION 123

TRAVEL 124

SERVICES

PROGNOSIS 2002



Data: Kennedy Information Inc.

POSITIVES

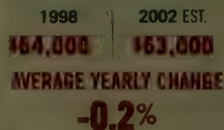
- Outsourcing will remain strong, as companies seek to boost operating efficiency
- Security will continue to be a high priority, creating a windfall for some companies

NEGATIVES

- Demand for much consulting will evaporate as clients cut costs
- Few firms will avoid layoffs, and many small firms may go under

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS



EMPLOYMENT

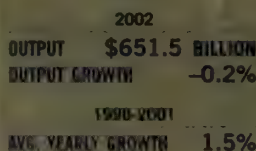
† = 250,000



10.3 MILLION

GROWTH PROSPECTS

C



Data: Economy.com

FIRST, KILL THE CONSULTANT

Most industries would have been thrilled with consulting's 2001 revenue growth. But for consultants, it was the worst year in a decade. Many were weaned on double-digit increases in the 1990s, so last year's gains—expected to end up in the mid-single digits—felt puny.

This year won't be much better, but there are some bright spots in the business arena known as professional services—a sprawling industry that includes the Big Five consultants and the consulting arms of IBM and other computer giants. With most clients in full cost-cutting mode, traditional consultants who help companies implement new strategies and technology may be shown the door. But more companies will be turning to outsourcing—essentially handing their back-office activities over to firms such as Accenture Ltd. and IBM Global Services, which manage these functions for their clients. Meanwhile, the September 11 terrorist attacks dramatically increased demand for security services, unleashing a deluge of business for Kroll, Visionics, and others. Both trends will roll ahead in 2002.

It's a good thing, too, because much of the consulting sector will be slowing to a crawl. Dean McMann, CEO of the Ransford Group, a Houston-based company that tracks the consulting industry, says the bloodbath that started in 2001 will continue this year. Few firms will avoid layoffs. And a few hundred boutique firms are likely to go under, as demand for strategy, operational, and technology advice remains weak. Sectorwide, Kennedy Information LLC estimates 2002 revenues, excluding outsourcing, will be \$127.3 billion—an increase of 6% and a slight improvement from 2001 revenue growth of 5%.

Why the recent slowdown? With the recession dragging on, companies are scrutinizing all nonessential costs, and consulting services rarely make the cut. Moreover, with technology spending down, the consulting industry has lost one of its biggest growth drivers—helping clients install newfangled computer systems. McMann says demand for information-technology consulting fell by 6% in 2001, with some companies seeing declines of up to 20%. "Consultants are the first ones booted out," says

Tom Rodenhauer, president of Consultation Services. "They suffer first and worst when times are bad."

Fortunately for Accenture and IBM, outsourcing services seem to blossom while conventional consulting work shrivels up. Data Inc. estimates that North American outsourcing revenues will grow from \$101.6 billion in 2001 to \$159.6 billion in 2005, while business process outsourcing revenues will expand from \$79.2 billion to \$142.7 billion. For the first nine months of 2001, outsourcing revenues grew 15% at IBM, and 50% at Cap Gemini Ernst & Young's North American business. Accenture expects to report that outsourcing revenues have increased 32% in the latest quarter compared to the year-prior period. And PricewaterhouseCoopers

rose 350% in two years. PwC partner Tom Banks, with amusement, understates: "View this as a hot market."

The U.S. collective obsession with security, meanwhile, has turned into a bonanza for Visionics Corp., a maker of facial-recognition software, and Kroll, which provides a range of services, including background checks for million-dollar security



ON GUARD: Security is one of the few areas of growth in an otherwise dismal landscape

assessments. Kroll is so busy in the wake of the terrorist attacks it's turning away six-figure assignments and expects its first profit quarter in more than a year. Visionics reported 2001 revenues of \$30.5 million, a 19% increase, and expects annual revenue growth of 35% to 50% in 2002. Says Visionics CEO John J. Atick: "We've become an industry with clear and present value proposition."

Outsourcing and security aren't the only pockets of growth in an otherwise dismal professional services landscape. KPMG Consulting is seeing double-digit growth in its public sector business, which provides consulting services for federal, state, and local governments. Some are predicting a resurgence in IT consulting, citing pent-up demand after the last spending drought. But that may be just wishful thinking. For consultants to thrive next year, they'll need to show they can make a contribution to the bottom line. For those who can't, the party's over.

By Louis Lavelle in New York

DIAGNOSIS 2002

SPOTLIGHT

REVENUES OF
FOR-PROFIT
EDUCATION FIRMS

'99 '00 '01 '02
BILLIONS OF DOLLARS —EST.—

Data: Eduventures.com

POSITIVES

Higher unemployment
drive up enrollments
for-profit institutions
serving to adults over 25
The Bush education
will buoy firms that
provide testing and
school management

NEGATIVES

The recession will cut
government spending on
schools and colleges
Venture-capital
investment in education
projects will stay anemic

PRODUCTIVITY

VALUE ADDED
PER EMPLOYEE, '01 DOLLARS

1998 2002 EST.
\$46,000 \$44,000

AVERAGE YEARLY CHANGE
-1.4%

EMPLOYMENT

▲ = 250,000

12.4 MILLION

GROWTH PROSPECTS

A

2002

OUTPUT \$542.5 BILLION
OUTPUT GROWTH 2.0%

1998-2001

YEARLY GROWTH 1.1%

Data: Economy.com

A NEW PUSH TO PRIVATIZE

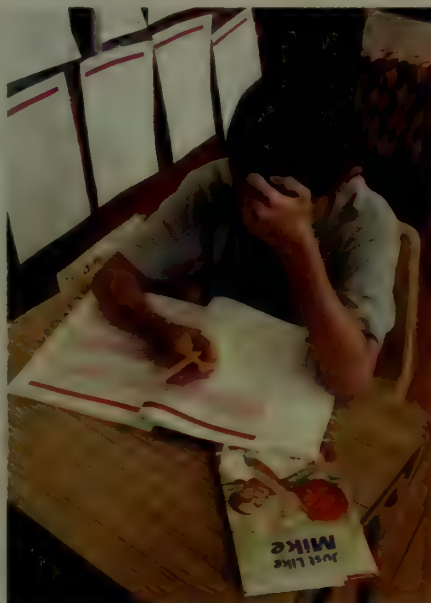
A year ago, the \$800 billion education industry seemed poised for rapid growth, propelled by public pressure to fix failing schools. But the war on terrorism has put school reform on the back burner, and the deepening recession has forced many states to scale back school spending. Meanwhile, venture capitalists—who had pumped \$5.5 billion into for-profit education companies in 1999 and 2000—turned down the spigot, cutting new investments by 75% in 2001.

As a result, 2002 is shaping up as a mixed year for education. Public spending on schools and colleges—which accounts for the bulk of education revenues—will continue to be squeezed as the recession cuts into tax receipts. Prior to September 11, “the rate of spending increases on education had already slowed sharply,” says Ted Sanders, president of the Education Commission of the States, which monitors nationwide education trends. Higher education has been hit the hardest, he says, forcing a 7.7% hike in tuitions at public universities in the current academic year, up from a 4.6% increase last year.

Even in this difficult environment, many companies in the for-profit education arena are succeeding. Eduventures, a Boston researcher, expects the \$113 billion for-profit sector to grow 5% this year—far faster than education or the economy as a whole. Consider the companies that manage public schools for a profit. They continue to face intense opposition from teachers’ unions and other critics. But H. Christopher Whittle, CEO of Edison Schools Inc., the largest for-profit schools operator, still expects revenues to soar 42%, to more than \$500 million, in the fiscal year ending June 30. And on December 21, after an acrimonious debate, school privatization got its biggest boost yet when the state of Pennsylvania took over the deeply troubled Philadelphia school system. As part of the takeover, Edison expects to receive a contract to manage 45 of the city’s schools.

A renewed federal focus on school reform will also help industry. “There’s no question that passage of President Bush’s education bill will propel growth” among for-profit companies

in the kindergarten-to-12th-grade sector, says Whittle. True, Congress refused to approve vouchers that parents could use to send their children to private schools. But the bill will prod alternatives such as charter schools, which are publicly funded but can be run by private companies. Meanwhile, the bill’s requirement that children be tested annually in grades 3 through 8 will create a bonanza for testing companies. Over the next five years, hundreds of millions of dollars will be spent “to help teachers and administrators prepare for these tests,” says Jonathan Grayer, president of test-prep leader Kaplan Inc.



TOUGH TEST: Diving tax receipts may batter school budgets

Equally strong tailwinds are behind companies such as Education Management Corp. and Apollo Group Inc., which provide post-secondary education to working adults. The recession will help boost enrollment at schools such as Apollo’s University of Phoenix because more workers look to retool during downturns. Fred McCrae, an education analyst at Thomas Weisel Partners LLC, thinks post-secondary outfits “should grow earnings 20% to 25%.”

In contrast, there won’t be much growth in the \$32 billion industry that provides corporate training, predicts Gregory M. Priest, CEO of SmartForce PLC. This

area will suffer as Corporate America continues to cut costs. But companies that provide training over the Internet, such as SmartForce, will shine. E-learning spending by companies should grow 73%, to \$7.3 billion, predicts International Data Corp. And once workers are exposed to e-learning on the job, they’re increasingly turning to institutions that allow them to earn college degrees online.

To be sure, the plunge in venture-capital funding triggered a brutal shakeout in 2001. “Most of the companies built on bad ideas over the past three years are gone,” says Peter Stokes, an executive vice-president at Eduventures. But for the survivors, the outlook is bright. “For-profit companies will play a larger and larger role in education,” says Gregory W. Cappelli, an analyst at Credit Suisse First Boston. Looks like the handwriting is on the classroom wall.

By William C. Symonds in Boston

PROGNOSIS 2002



Data: Deutsche Banc Alex. Brown

POSITIVES

- Airlines and hotels will be cheered by lower fuel costs and reduced wage pressures
- With fewer new hotels opening or jets being delivered, existing players will benefit from a slowdown in capacity growth

NEGATIVES

- A rebound in lucrative business travel could lag behind the economic recovery

PRODUCTIVITY

VALUE ADDED PER EMPLOYEE, '01 DOLLARS

1998 2002 EST.

\$59,000 \$61,000

AVERAGE YEARLY CHANGE

0.9%

EMPLOYMENT

↑ = 250,000



5.3 MILLION

GROWTH PROSPECTS

C

2002

OUTPUT \$323.5 BILLION

OUTPUT GROWTH 0.3%

1998-2001

AVG. YEARLY GROWTH 3.3%

Data: Economy.com

AIRLINES: HOW UGLY?

For the beleaguered U.S. travel industry, the outlook for 2002 is either bad or downright ugly. It all depends on how quickly the nation's business travelers get moving again. The timing and strength of the recovery will be one factor. But the industry must also reckon with travelers' post-9/11 fears and the hassle factor created by new security measures at the nation's airports. "All of it is fairly depressing," notes Philip A. Bag-galey, airline analyst at Standard & Poor's.

Bad as the prospects are, however, 2002 will likely be better for the airlines than last year. In 2001, some carriers were pushed to the edge of bankruptcy by the aftershocks of the terrorist attacks. Not factoring in the government's \$5 billion bailout, operating losses for the top nine carriers totaled an estimated \$7 billion on revenues of \$84.7 billion, which fell 15% from 2000, says analyst Susan M. Donofrio of Deutsche Banc Alex. Brown Inc. The red ink will continue to flow in 2002, she predicts, with operating losses of \$2.4 billion on \$86.2 billion in revenue. Only by 2003, if all goes well, will carriers see operating profits: \$3.7 billion on revenues of \$99.7 billion.

Some carriers are poised to do better than the pack. Southwest Airlines Co. is likely to show a profit this year, thanks to its low-cost business model. "Low fares work in our favor in a weaker business travel environment," says CFO Gary C. Kelly. And Gordon M. Bethune, CEO of Continental Airlines Inc., predicts he'll outpace many rivals, thanks mostly to a better product and "foolish" cost-cutting by competitors, who are dropping even bare-minimum amenities such as in-flight meals and magazines. He anticipates a profitable second quarter; analysts foresee a net loss for the year.

One thing is sure to help the industry. In the wake of the terrorist attacks, airlines cut capacity 20% by flying some planes less each day and mothballing others. Of these, American Airlines CFO Thomas W. Horton figures the oldest planes will not return to service. Industry capacity, then, could be down 6% by the end of next year, compared with pre-September 11 levels. With less capacity and an economic

pickup, "You can build a case for a recovery in the airline industry," says Horton.

There's also a little blue sky in the culture. Fuel prices are falling, and the country's bleak financial outlook has put a lid on labor's wage demands. Indeed, analysts say United Airlines and US Airways Group will win givebacks this year from labor to get them stay in the air. That could set a path for others to follow.

Some analysts think weak carriers such as America West Airlines and US Airways will be forced to restructure or merge in 2002.



GROUNDING: Even with the bailout, the airlines could see big losses

who would buy them? The biggest players are holding money and would meet steep resistance from unions, as long as their members remain laid off. The fates of the weak carriers will be decided, in part, by how the federal government chooses to dole out \$10 billion in loan guarantees.

When airlines struggle, hotels suffer, too. Consultant Bjorn Hanson of PricewaterhouseCoopers notes that 64% of journeys involving hotel stay include an air trip. This year, occupancy will sink to 59.6%, the lowest level since 1971. Revenue per available room will drop 0.2%—on the heels of a 6.7% decline in 2001, the worst drop since

the Great Depression. After plummeting 27% last year, total industry profits should grow a modest 1.8%, to \$17.1 billion, on revenues of \$110 billion, thanks in part to some cost-cutting.

Compared to their brethren in the hotel and airline businesses, car rental executives have far more flexibility in adjusting capacity to demand. Avis, owned by Cendant Corp., for instance, has cut its fleet to about 170,000 vehicles from 230,000 since August. Similar moves by competitors have helped support recent efforts to raise rental rates. Even so, because of the severe slowdown in business travel, average rates will fall about 4% this year, says David Romano, senior director of revenue management at Budget Group Inc. Cheap plane tickets, discounted hotel rooms, and cut-rate rental cars: It means that for the first time in years, business customers have everyone in the travel industry over a barrel.

By Wendy Zellner in Dallas

Where does the CFO turn when everyone is turning to the CFO?

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20 EURO

50 EURO

100 EURO

200 EURO

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NO LONGER OLD HAT?



GENE MARCIAL
ANALYST

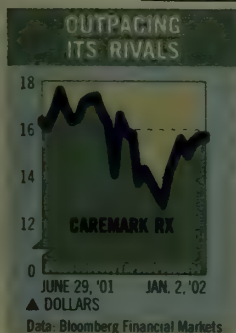
Red Hat's boost
Big Blue has
investors
ing. Drug
butor
mark delivers
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alist PEC is
roll

Remember Red Hat (RHAT)? Once fodder for cocktail-party buzz, the stock zoomed to a 151 high in December, 1999, four months after a dazzling Nasdaq debut. By Sept. 17, 2001, it traded at a lowly 2.4. Champions went mum until recently: Shares of the Linux operating system distributor have leapt to 7 since Nov. 27, when IBM said it would collaborate with Red Hat to develop software and services for its fleet of eServer products. IBM carved Red Hat a slice of its fat \$1.3 billion budget this year for projects using Linux—an operating system that allows users to customize software rather than buy a one-size-fits-all product from, say, Microsoft.

So far, Wall Street isn't impressed by the recent gains: Four of five analysts who cover the stock are still bearish, according to Zacks Investment Research. But at least one gutsy stock-picker says Big Blue's deal signals that Red Hat has longevity. Contrarian Bernie Schaeffer of Schaeffer's Investment Research issued a special bulletin to his newsletter subscribers recommending Red Hat, which he thinks could trade at 20 in a year. "I make no bones about it being risky," he says. "But it could be one of those situations where the potential rewards are explosive."

While Red Hat is the global leader in Linux-customized technology—its market share is 60%—it faces fierce competition from Microsoft and Sun Microsystems' server-based products. This year could mark a turning point: Blue-chip users increasingly are choosing flexible operating systems and opting to sidestep steep up-front license fees. Further, Red Hat beat analysts' predictions with earnings before noncash items, like goodwill, of \$1.3 million, or a penny per share, for the fiscal third quarter, compared with breakeven results the prior quarter. Management says the fourth quarter will be profitable.

BIOTECH WITH A TWIST



The hoped-for surge in biotech drugs could be the prescription for fresh growth at Caremark Rx (CMX). The \$4 billion Birmingham (Ala.) outfit is already one of the largest pharmaceutical services companies in the U.S., distributing drugs and administering benefits for big corporations and insurance companies. It also operates a booming mail-order business.



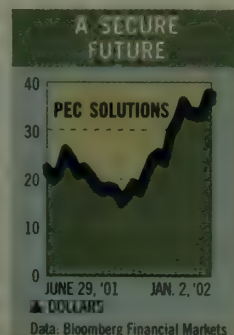
Analysts have issued incremental upgrades throughout the past year as the company's earnings beat projections. Through the nine months ended Sept. 30, 2001, net revenues rose by almost a third, while profits jumped 72%, to 50¢ a share. That pushed the stock to 16, a 20% one-year gain. But there's more to Caremark than the HMO-style distribution model, which has low margins, says Rob Plaza, a Morningstar stock analyst: "If that's all they were, I wouldn't be as high on the stock." Plaza says Caremark is among the few drug distributors with the knowhow to deliver speciality therapies to at-home patients for such severe illnesses as hemophilia and multiple sclerosis. Although there's competition from Gentiva Health Services and Priority Healthcare in the new biotech arena, Plaza says Caremark is miles ahead. Analyst Anne Barlow of SWS Securities is also bullish: She expects the stock to double in 12 months.

PEC'S PENTAGON POWER

The war on terrorism could open up more doors for PEC Solutions (PECS). The Fairfax (Va.) company not only develops systems to improve the efficiency of government and the armed forces' use of the Internet—but also builds the security systems that safeguard sensitive data. Private for 16 years before going public in April, 2000, it has been on a roll: Reported profits of \$3.7 million in the third quarter of last year amount to a 64% increase over the prior year. Revenues were up as much, to \$29 million. Then came September 11: PEC's stock quadrupled in 2001, to 37.5.

At this level, it trades at a lofty 58 times consensus earnings forecast of 64¢ a share for 2002. UBS Warburg equity analyst Adam Frisch adds, "The estimates for this year may turn out to be conservative." That's because some new developments aren't yet built into the forecast: On Nov. 20, PEC acquired rival TROY Systems for \$18 million. TROY will contribute at least an estimated \$33 million in revenues and 5¢ in PEC's per-share earnings. But not all the benefits of the merger have played out. Cross-selling and margin improvements could bolster profits. Even more, anticipated IT security contracts from the new Office of Homeland Security and government offices—forecast to jump 15% to \$65 billion by 2007—have not been calculated into the mix.

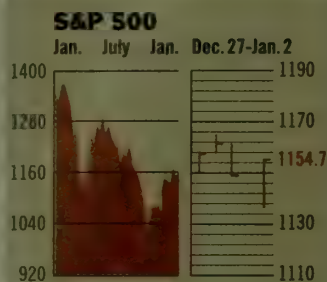
Gene Marcial is on vacation.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNN's *The Money Gang*.

Stocks



COMMENTARY

Equities began 2002 on a positive note, with the Dow Jones industrial average, the S&P 500 index, and the Nasdaq Composite rising 0.5%, 0.6%, and 1.5% respectively. Adding to Wall Street's cheer was a report on Jan. 2 pointing to a rebound in U.S. manufacturing. Cisco Systems, rising 6.2%, and Intel, up 4.9%, paced the large-caps in the first trading session of the year.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Jan. 2	Week	% change	
			Year to date	Last 12 months
S&P 500	1154.7	0.5	0.6	-10.0
Dow Jones Industrials	10,073.4	-0.1	0.5	-5.4
Nasdaq Composite	1979.3	0.9	1.5	-13.6
S&P MidCap 400	506.5	-0.3	-0.4	2.4
S&P SmallCap 600	231.7	-0.6	-0.2	10.3
Wilshire 5000	10,750.9	0.4	0.4	-8.6

SECTORS

			% change	
			Year to date	Last 12 months
BusinessWeek 50*	729.1	0.3	-0.1	-21.1
BusinessWeek Info Tech 100**	425.8	1.6	1.5	-19.7
S&P/BARRA Growth	599.8	-0.2	0.9	-8.8
S&P/BARRA Value	553.6	1.1	0.3	-11.8
S&P Energy	818.4	-0.2	0.0	-13.7
S&P Financials	147.4	0.9	0.0	-8.0
S&P REIT	93.5	0.4	0.1	7.0
S&P Transportation	686.7	0.0	0.0	-0.8
S&P Utilities	236.6	1.4	0.0	-30.1
GSTI Internet	105.5	1.2	0.5	-33.2
PSE Technology	695.8	1.3	1.2	-9.3

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %		Last 12 months %
Office Electronics	24.1	Office Electronics	84.8
Internet Software	19.7	Computers & Electronics	65.1
Homebuilding	18.5	Specialty Stores	59.2
Building Products	15.9	Metal & Glass Containers	50.5
Health-Care Suppliers	13.5	Motorcycle Manufacturers	44.1

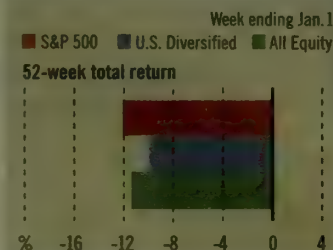
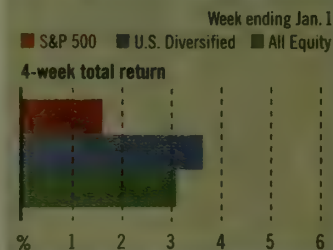
EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders			
Latin America	8.0	Precious Metals	20.8
Small-cap Value	6.6	Small-cap Value	15.4
Small-cap Growth	6.4	Real Estate	9.9
Small-cap Blend	6.2	Mid-cap Value	7.5
Laggards			
Japan	-3.4	Technology	-35.9
Health	0.4	Communications	-35.0
Diversified Pacific/Asia	0.6	Japan	-28.8
Domestic Hybrid	1.1	Europe	-22.9

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders			
Frontier Equity	24.2	Pilgrim Russia A	80.3
Van Wagoner Emerging Gr.	16.3	Schroder Cap. Ultra Inv.	73.5
Van Wagoner Post Venture	15.5	Matthews Korea	71.1
Polynous Growth A	15.0	Ameristock Focused Value	60.4
Laggards			
American Heritage	-11.1	Berkshire Focus	-72.2
World GenomicsFund.com	-10.9	Berkshire Technology	-71.7
Banknorth Large Cap Value	-9.7	Merrill Lynch Focus 20 B	-70.4
Potomac Internet Short	-8.4	Van Wagoner Mid-Cap Gr.	-66.4

Mutual Funds



Data: Standard & Poor's

THE WEEK AHEAD

FACTORY INVENTORIES Tuesday, Jan. 8, 10 a.m. EST ► Manufacturing inventories probably fell 1% in November, after a ninth consecutive decline in October of 0.4%.

INSTALLMENT CREDIT Tuesday, Jan. 8, 3 p.m. EST ► Consumers likely added \$5 billion of debt in November, after piling up \$7 billion of new debt in October. That's according to the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill

Companies. Since June, consumers have paid off over \$10 billion of revolving credit—consisting primarily of credit card debt. Conversely, incentives by automakers and low mortgage rates have enticed consumers to pile up \$23 billion of non-revolving debt over the past four months.

EXPORT-IMPORT PRICES Thursday, Jan. 10, 8:30 a.m. EST ► Import prices in December likely dropped 0.6%, while export prices probably fell 0.3%. In November, falling oil prices pulled import prices

down 1.6%. Petroleum prices had 41% over the past twelve months.

PRODUCER PRICE INDEX Friday, Jan. 8:30 a.m. EST ► Producer prices of finished goods during December are cast to have fallen 0.2%, after a drop in November. Core prices, excluding the volatile food and energy categories, probably rose 0.1%, after a 0.2% November increase. Differences between the headline and core indexes are a long slide in crude-oil prices.

GLOBAL MARKETS

	Jan. 2	Week
S&P Euro Plus (U.S. Dollar)	1085.2	4.4
London (FT-SE 100)	5218.3	0.8
Paris (CAC 40)	4580.4	1.7
Frankfurt (DAX)	5167.9	3.0
Tokyo (NIKKEI 225)	10,542.6	3.4
Hong Kong (Hang Seng)	11,350.9	1.3
Toronto (TSE 300)	7646.8	1.2
Mexico City (IPC)	6410.1	0.6

FUNDAMENTALS

	Dec. 31	Wk.
S&P 500 Dividend Yield	1.36%	1
S&P 500 P/E Ratio (Trailing 12 mos.)	47.8	4
S&P 500 P/E Ratio (Next 12 mos.)*	21.8	2
First Call Earnings Surprise*	8.13%	1

*First Call Corp.

TECHNICAL INDICATORS

	Dec. 31	Wk.
S&P 500 200-day average	1166.9	1168
Stocks above 200-day average	56.0%	51
Options: Put/call ratio	0.67	0.6
Insiders: Vickers Sell/buy ratio	2.39	2.1

WORST-PERFORMING GROUPS

	Last month %		Last 12 months %
Food Retail	-11.4	Multi-Utilities	
Biotechnology	-9.0	Computer Storage	
Automobile Manufacturers	-9.0	Telecomms. Equip.	
Agricultural Products	-7.9	Electronic Equip. &	
Multi-Utilities	-7.4	Network Equipme	

Interest Rates

KEY RATES

	Jan. 2	Week at
MONEY MARKET FUNDS		
90-DAY TREASURY BILLS	1.73	1.72
2-YEAR TREASURY NOTES	3.20	3.23
10-YEAR TREASURY NOTES	5.16	5.20
30-YEAR TREASURY BONDS	5.56	5.53
30-YEAR FIXED MORTGAGE†	7.21	7.25

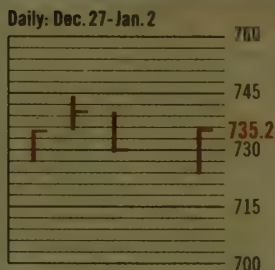
†BancQuote, Inc.

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Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.55%
TAXABLE EQUIVALENT	5.59
INSURED REVENUE BONDS	4.68
TAXABLE EQUIVALENT	5.78

BusinessWeek Fifty

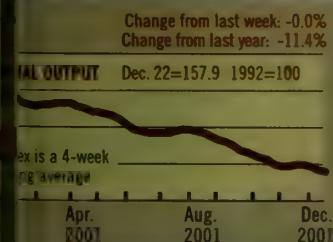


se 0.3% for the week ending Jan. 2, as more than 75% of the companies on the list finished in
ry. Leading the surge was the utility-power provider AES, which rose 12.7%. The brightest spot
however, was in technology, where storage giant EMC jumped 11.1%, DRAM maker Micron Tech-
d in 9.3%, and programmable chip manufacturer Xilinx leaped 8.2%.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	-2.7	4.9	26	Verizon Communications	2.7	0.1
Petroleum	-0.8	-13.3	27	Citigroup	1.6	4.9
	5.3	-62.2	28	Sun Microsystems	6.7	-35.0
	7.1	-44.3	29	Merck	-0.3	-25.1
Materials	2.8	-8.1	30	El Paso	1.6	-35.7
Financial	8.6	-92.8	31	Altera	5.7	-11.8
Oil Petroleum	-1.2	11.1	32	Marsh & McLennan	0.9	1.2
	1.0	-8.3	33	Household International	1.3	-2.2
ee	0.2	-16.4	34	ChevronTexaco	0.3	3.0
	-0.8	-34.6	35	SBC Communications	2.0	-12.3
Brothers Holdings	-1.5	-4.8	36	Mercury Interactive	2.8	-41.8
	11.1	-65.5	37	AOL Time Warner	0.5	-28.2
	12.7	-69.3	38	Washington Mutual	1.8	-3.6
Laboratories	-1.2	18.9	39	General Dynamics	2.7	19.2
on Financial	-0.6	-12.4	40	Comcast	0.8	-17.1
Technology	9.3	-7.4	41	Morgan Stanley Dean Witter	-0.4	-13.2
	8.2	0.1	42	Tellabs	6.3	-63.1
Hess	0.7	-14.2	43	Exxon Mobil	0.0	-2.7
rgy	3.1	-3.8	44	Scientific-Atlanta	9.4	-45.7
ommunications	1.7	-57.7	45	U.S. Bancorp	0.2	-11.6
Financial	3.5	-4.8	46	Paychex	-2.6	-12.3
Petroleum	-0.5	12.4	47	Merrill Lynch	1.2	-13.3
Services	4.5	10.1	48	Bed Bath & Beyond	0.1	33.2
Drugs	-2.3	-12.7	49	Texas Instruments	2.7	-11.0
Health	0.0	-4.0	50	Teradyne	6.8	-0.8

Production Index



n index remained unchanged over the
ore calculation of the four-week moving
dex increased to 159.0, from 157.3 for the
c. 15. On a seasonally adjusted basis, au-
posted large gains as automakers an-
ases to first-quarter production sched-
refining, rail-freight traffic, and electric
e. Steel and coal remained unchanged,
roduction fell for the week.

ch of the index components is at www.business-week.com
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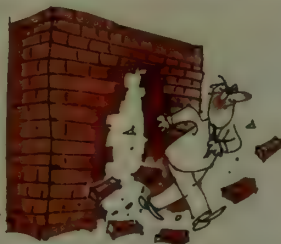
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GOOD LUCK, MAYOR BLOOMBERG

Michael R. Bloomberg was until recently better known in the canyons of Wall Street and office towers of Corporate America than in the streets and neighborhoods of Brooklyn, Queens, the Bronx, Staten Island, and most of Manhattan. His ubiquitous Bloomberg computer screens provide much of the financial data that power global stock, bond, and commodity markets. Now the self-made billionaire entrepreneur, who built his business in New York City, is its 108th mayor.

A businessman-mayor is a most remarkable event in a liberal city often indifferent to economic development. Even outgoing Mayor Rudolph W. Giuliani, for all his brilliant successes, did little to change that tradition. Giuliani "normalized" New York and reintegrated it into America by restoring order and bringing common sense back to social policy. Bloomberg now has the opportunity to build on this foundation and bring his skills as a pragmatic manager and innovator to the economic sphere. September 11 and the recession have left New York with a budget deficit of \$4 billion and 100,000 newly unemployed.

The most immediate problem is cutting the deficit. Giuliani had an economic boom to fill the city's coffers and avoided tough negotiations with unions. Bloomberg can't. Firefighters, police, and teachers have been working without contracts, and their salaries aren't competitive with most nearby suburbs. Given their heroic efforts and new role in securing the city against terrorism, the firefighters and police are in line to get decent increases. But with tax revenues falling, that money must come from wringing greater efficiencies from the rest of the city's workforce. The recession has forced employees in the private sector to accept pay freezes, givebacks, and layoffs. Municipal workers may well have to bear the same burden. At the very least, any raises should be justified by higher productivity. Bloomberg got off to a good start by announcing a 20% reduction in his own staff.

Bloomberg must also draw up a viable long-term econom-

ic plan for the city. Making New York economically competitive should be a significant goal. As a CEO, he knows doing business in New York is a difficult, byzantine affair with endless red tape, archaic zoning laws, and, of course, the highest taxes in the country. As a purveyor of electronic data, Bloomberg is in a good position to computerize government work and put government functions on the Web. A long-term plan to bring down in later years New York's personal and business taxes is crucial.

Bloomberg's toughest job will be rebuilding the schools and the city's human capital. New York has some of the best private and parochial schools in America and many good public schools as well, but most of its inner-city schools are in terrible shape. Teachers complain that many of their students come from homes that are broken and lacking clocks or from rural areas in foreign countries and can't even write in any language. Critics counter that the schools are too short, that union rules—not performance—dominate, and accountability is lacking. The truth is that even if the education debate is right, Bloomberg needs to find money for schools but he also needs to make schools more accountable. To do that, the New York state legislature must give the mayor direct authority over the city's school system, as the case in Chicago, where early results are promising. Bloomberg couldn't get the necessary control. Bloomberg must. Bloomberg also should bring in Edison Schools Inc. and others to provide competitive benchmarking. Not least, he needs to liberate City University in its traditional role of providing quality education to immigrants and the poor.

Rudy Giuliani will always be known as the mayor who turned New York City around and guided it through the trauma of September 11. Michael Bloomberg has the chance to be known as the mayor who steadied New York through the crisis and set her course into the new century. Wish him luck.

A DARK YEAR'S 25 STAR MANAGERS

Last year was a dark one for many CEOs, and it wasn't just the recession. The Enron debacle, which cost investors \$60 billion, was marked by subterfuge and incompetence, if not outright lying, from its top managers. Accounting scandals, bad mergers, and hyped promises haunted other chief executives. Confidence in the truthfulness of people leading corporations dropped. Whom are investors to believe as the new year begins and the recovery beckons? We don't know the whole answer, but the 25 executives chosen by *BusinessWeek* as the best managers of the year may be one place to begin.

This year's best managers succeeded by focusing on the fundamentals, by knowing what was important for their busi-

ness, and by managing well. Even among technology companies—the sector hit hardest in the downturn—some managers found a way to excel. Lou Gerstner's skillful handling of IBM is expected to produce \$7.7 billion in profits for 2000, slightly below the \$8.1 billion reported in the boom year of 2000. As of Dec. 28, its stock was up 45% for the year. Whitman guided eBay Inc. to beat third-quarter forecasts with a 71% jump in sales. And Craig Conway of PerkinElmer Inc. doubled spending on research and development and reaped the benefits: Third-quarter revenues rose 15% year over year, and profits doubled, to \$50 million.

Take a close look at the Top 25 Managers of the Year (p. 52). There are many valuable lessons to be learned.

January 21

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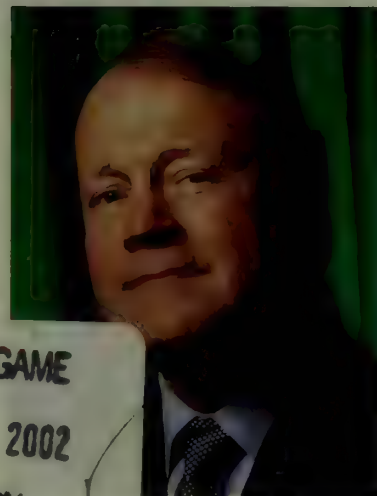
BusinessWeek

21, 2002

A PUBLICATION OF THE MCGRAW-HILL COMPANIES

CISCO BEHIND THE HYPE

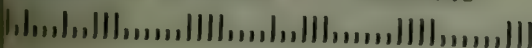
CEO **JOHN CHAMBERS** still insists his company can grow at least 30% a year. But critics disagree, questioning Cisco's aggressive accounting. Some even say Cisco's earnings in the boom years were wildly inflated. Is Cisco really worth 95 times earnings?



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By JOHN A. BYRNE AND BEN ELGIN

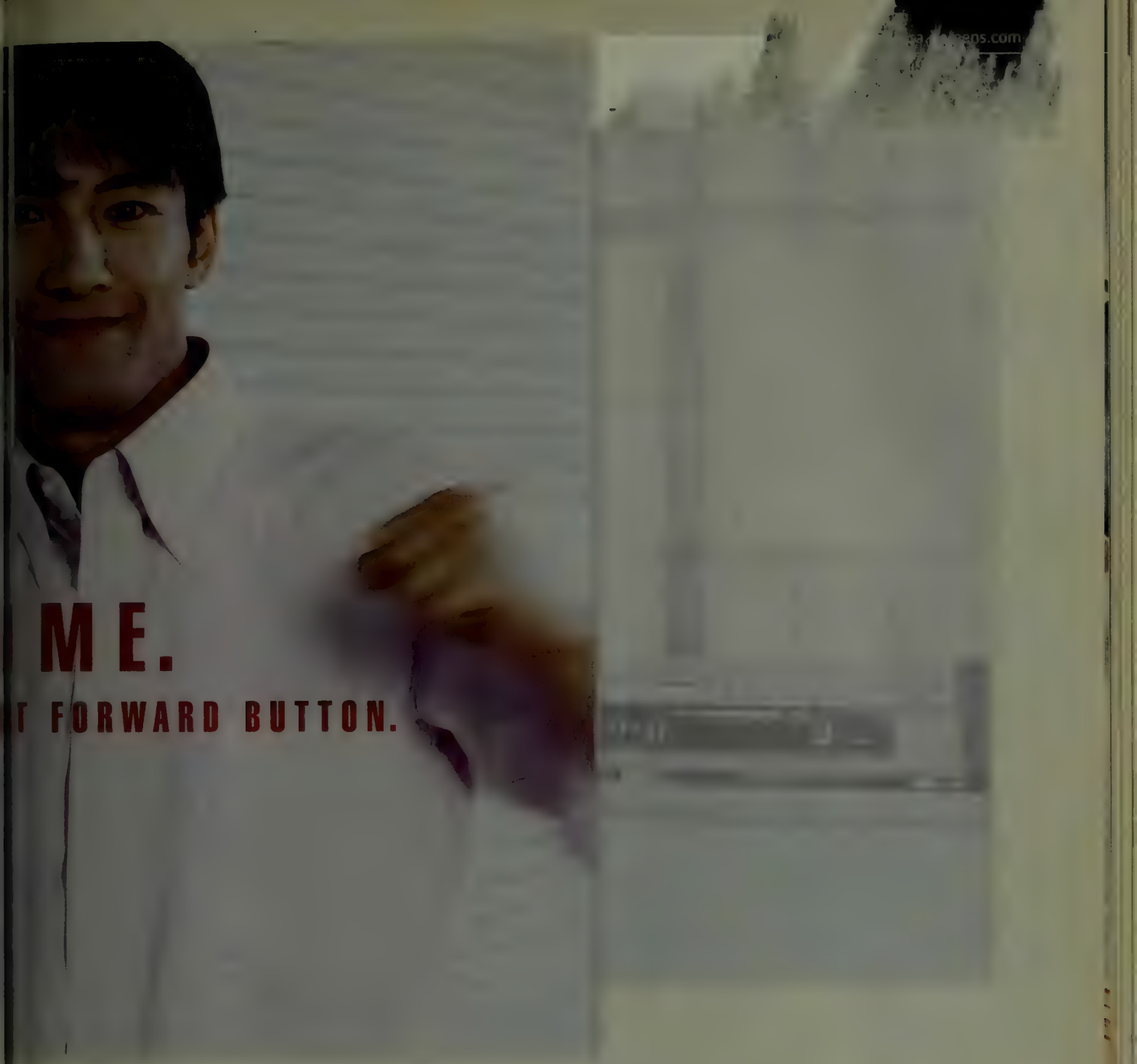
As a product developer at JVC,
I was asked to create a hybrid
VCR that would revolutionize the
way people watch TV programs.
The challenge was to make it
no bigger than a standard VHS
recorder and get it to market within
a year. Did I reach my goal? You bet.



I CAN BE
I HAVE A FINGER ON

JVC
— AND —
FUJITSU
LSI TECHNOLOGY

JVC wanted to create a VCR like none other. One that combines the multifunctions of a hard disk drive with the familiarity of a VCR. So TV programs can be recorded and played back simultaneously. Size, of course, was a factor. So was time. That's why JVC chose Fujitsu's high-performance, highly integrated semiconductor solution, which provided all the necessary circuits on a single 28mm chip. With the technology and expertise provided by Fujitsu, JVC successfully developed a finished product within one year. Now even more people are tuning in to JVC. For more details, visit us.fujitsu.com/casestudy/. With a partner on the cutting edge of technology, you can accomplish anything.



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A woman with long blonde hair, wearing a white tank top and patterned shorts, is sitting on a wooden deck. She is leaning over a laptop, which is open on her lap. She is holding a pen in her right hand and appears to be writing or pointing at the screen. The deck is made of wooden planks. In the background, there is a large, stylized globe of the Earth, showing the Americas. The scene is lit with warm, golden light, suggesting sunset or sunrise. The overall mood is professional and global.

SIEMENS

Global network of innovation

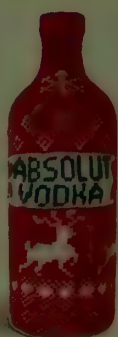
COVER STORY

CISCO: BEHIND THE HYPE

The CEO sees hot growth ahead—but critics say Cisco's numbers tell a different story **page 54**

BusinessWeek

JANUARY 21, 2002



CREATIVE HANGOVER

A downside to bringing liquor ads back to TV **page 52**



Cover Story

54 CISCO: BEHIND THE HYPE

The tech giant's sales are in a slump, profits are sagging, and the stock price is in a swoon. Despite all this—not to mention a wonky economy—CEO John Chambers maintains his company can grow 30% to 50% annually. He points to new markets in wireless and optical networking, voice-over-Internet, and storage area networks. But skeptics say Cisco will face competition unlike anything it has ever seen, and a hard look at its books even calls into question the reality of its glory days

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any of advisers
to make
is off
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Corporation

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McNerney is making major
changes in the way the company is
to reach his lofty goals

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TV advertising dampen the
creative spirit that gave birth to
memorable campaigns?

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Year after the merger with
base Manhattan, the bank is
racking up big losses

WING UP A BEHEMOTH

Under CEO Lewis, Bank of America
leaner but more profitable

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Swinging up millions in donations is
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By falsely saying John Nash was ill
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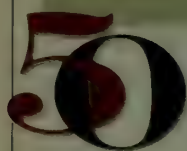
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S&P's David Wyss on when the economy will bottom—and how strong the rebound will be



■ TO-DO LIST:

The pressing issues President Bush needs to tackle in 2002, from BW's Bob Dowling



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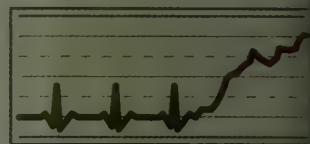
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Strong Vital Signs

Hospital operator Tenet Healthcare should continue to prosper, thanks to aging baby boomers and an aggressive push for higher reimbursement rates from HMOs



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Up Front

EDITED BY
SHERIDAN PRASSO



CAR TALK

HERE COME THE KIDDIE CARS

THE RETRO FORD THUNDERBIRD and Chrysler PT Cruiser may be today's hot cars, but designers at the Detroit auto show were focused on tomorrow's buyers—even those not yet old enough to drive. Aiming to catch youngsters in anticipation of their first purchases later on, carmakers went after "Millennials," aged 11 to 22, with what perhaps should be dubbed Kiddie Cars.

Chrysler made a big splash, with four Kiddie concept cars priced at \$12,500 to \$17,500. The Dodge Razor (\$14,500), for example, is a minimalist sports car for young buyers.

MINIMALIST: Dodge Razor

It doesn't even have a radio, which young people tend to rip out and replace with a stereo anyway. But the car's name may damage its marketing potential, coming, as it does, from the Razor scooter. Way cool a year ago, they're now lame. Chrysler defends licensing the name, saying Razor still makes hot products, such as pogo sticks.

Other Kiddies: Toyota's Matrix, a funky wagon soon out for \$15,155, and Honda's Model X, a dorm room on wheels aimed at guys. With a washable, fold-down interior, it will debut later this year for under \$20,000. As for the boomers? They get crossover SUVs. *Joann Muller*

SHOW BIZ

DVDs ARE TURNING INTO A SOLID GOLD HIT



MUST-SEE: Sales doubled in 2001

HOLLYWOOD'S BIGGEST BLOCKBUSTER LAST year wasn't named *Harry*. It was a little, shiny DVD disk. U.S. consumers spent more than \$6 billion in 2001 buying or renting movies on DVD—a number fast closing in on the \$8.35 billion they spent at the box office, according to the studio-backed DVD Entertainment Group. That's more than double the 2000 total for DVDs, while the number of movie tickets sold in 2001 remained roughly flat.

Costing less than \$1 each to produce, retailers can usually sell a DVD for \$20 and return a hefty margin to Hollywood studios. "DVD is our engine of growth," says Steve Beeks, president of Artisan

Home Entertainment, which last year dipped into its 6,700-film library to release on DVD the likes of *Rambo* and *Terminator 2*.

The economics are especially compelling for older films, such as Walt Disney's 1937 classic *Snow White and the Seven Dwarfs*, which already had earned more than \$126 million at the box office. Disney spent an estimated \$1 million extra for goodies, including a documentary, an interactive guide that looks like *Snow White's* mirror, and games. Shipping 5 million copies, it stands to make \$10 to \$12 per disc, or more than \$50 million on that film alone.

Video consultant Adams Media Research forecasts DVD sales increasing 33%, to \$9 billion this year. And since only 23% of U.S. households own DVD players, a number expected to hit 34% in 2002, there's plenty more ahead. *Ronald Grover*

TALK SHOW "They felt me up and down like a prize steer."

—Rep. John Dingell, 75, on being forced to strip at Reagan National Airport after his artificial hip set off a metal detector

I-WAY PATROL

YES, THEY REALLY PAY TO SEE THESE SITES

INTERNET COMPANIES never expected to give away content forever. The plan was to get people hooked, then convert them to paying subscribers. Now, with ad revenues falling, they're pushing more than ever to do that.

But a *BusinessWeek* look at a half-dozen dot-coms trying to make the switch finds only limited success. Those providing financial services—such as TheStreet.com, EDGAR Online, and Economy.com—are doing well, largely because institutions pay their high charges.

But sites catering to the public are having a much harder time. Online magazine Salon.com, which started subscriber-only content in March, and Britannica.com, which began charging in July, say they're meeting or surpassing their expectations—but they

have yet to convert even of the more than 3 million people who click on their monthly. Salon has sold 29,000 subscriptions,

a month; Britannica, \$7.95, has sold 3

Financial new viduers, though following *The Street Journal's* insisting that re pay for online a and getting re TheStreet.com, launched a new site in 2000, got thirds of its \$3.5 million third-quarter 2001 enue from 76,000 scribers. About 80 revenue for EDGAR (which provides Sec & Exchange Comm

filings, now comes from porate subscribers. A search firm Econom says it broke even on its site in December, just after it began charging a month. "We would given it two years," pleased CEO Paul Ge That's a luxury few dot can afford. *Kimberly V*



THE LIST SPLENDOR IN THE SUITES

Zagat ranks these hotels as top of their class for business travelers worldwide, outside the U.S. Here's why:



3 THE RITZ-CARLTON MILL Singapore

Telephone with multilingual voice mail; technology butlers assist with IT questions

4 FOUR SEASONS GEORG Paris

In-room fax, data port; suites have private office space

1 THE PENINSULA Hong Kong

Highest staff-to-guest ratio in city; in-room fax and Internet

2 THE ORIENTAL Bangkok

Helicopter service to and from airport; spa/sports center boasts squash courts

5 LANESBOROUGH London

Digital interactive system converges e-mail, Internet music, and TV/films; personalized business cards on arrival

Data: Zagat Survey 2001 Top International Hotels, Resorts & Spas



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Up Front

SPORTS BIZ

RULE No. 1 AT THIS NEW CLUB: NO DAMES

THESE DAYS, WOMEN RUN SOME OF AMERICA'S BIGGEST corporations. They sit on the U.S. Supreme Court, referee National Basketball Assn. games, pilot airplanes, and even outnumber men as students at many universities. But there's one place where you won't find them: Chicago's newest golf club.



SERIOUS GOLF: A guy thing?

Opening in April, the Black Sheep Golf Club will be men-only. Notwithstanding the 1987 Supreme Court ruling outlawing no-women rules in "business-oriented" clubs, the 27-hole facility is exempt because it's a private sports club. Membership costs \$85,000, plus \$625 monthly dues. The Black Sheep joins only a few dozen golf clubs in the nation with the distinction.

Why the policy? The club wants to appeal only to serious golfers, and Vincent Solano, president of the firm managing the project, contends that those are almost always men. Besides, he adds, sometimes men want a place where they can just be one of the guys. "We mean no offense to women," says Solano.

Some take offense, nonetheless. "It's not a concept we support in any way," says Libba Galloway, chief legal officer for the 400-member Ladies Professional Golf Assn.: "We are against discrimination in any form." But men-only links may be on an upswing. Yet another, Southern Dunes Golf Club, is due to open outside Phoenix in 2003.

Watch out, guys—Justice Sandra Day O'Connor is known to be an avid golfer.

Michael Arndt

DRAWN & QUARTERED

OH, THOSE ARE IN CASE I NEED SOMETHING TO RESTRAIN A FELLOW PASSENGER.



FUN CITY

POST-TRAUMATIC STRIP SYNDROME

EVERYONE HAS DIFFERENT ways of dealing with the country's newfound stress. Some have turned to chocolate, others to exercise. But for a small number, plain old aerobics are passé. They've turned to Cardio Striptease.

The skin-baring exercise class is offered in Los Angeles and New York by Crunch, a hip health club with 150,000 members nationwide. (It was recently bought by industry-leader Bally Total Fitness for \$90 million.) The weekly sessions, included in the membership fee, teach lap dancing, gyrating, and erotic posturing. New York classes, which began in October, draw about 30—twice the norm for launches. And the crowd

that's taking it off is tired and multigenerational. It isn't the norm, but end up scantily clad.

Course creator Jeff 31, says he sensed a need to bounce back to normal.



then some: "People really appreciated letting loose and getting rid of pent-up energy." Thelma Ostrow, a fitness enthusiast, says it "a lot of fun. You can get your head off and do it in a real safe environment." She plans a home video for those who can't bear to go to public.

Julia Co

THE BIG PICTURE

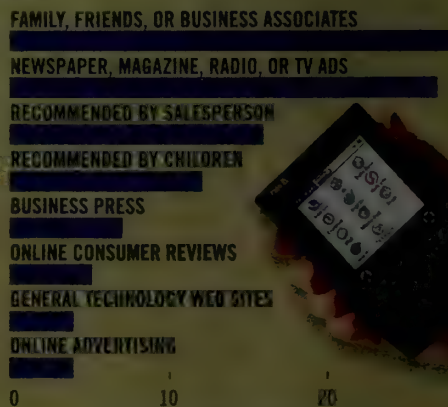
HOW PEOPLE BUY TECHNOLOGY

Percentage of affluent shoppers making their most recent computer or consumer electronics purchase at:



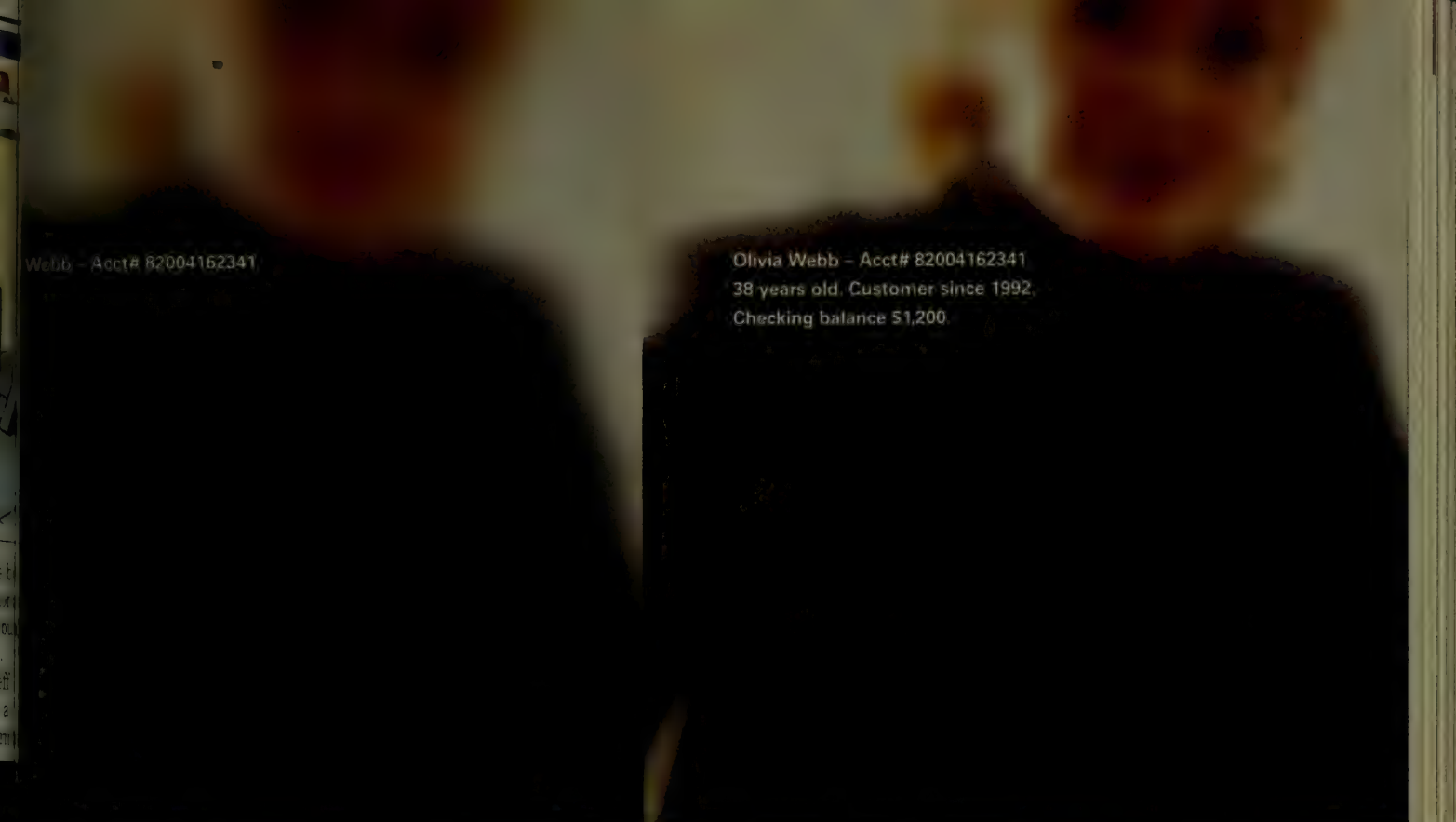
SURVEY OF 2,500 AMERICANS WITH \$1 MILLION OR MORE IN INVESTABLE ASSETS. RELEASED ON NOV. 16

Percentage of affluent shoppers who say their purchases of consumer electronics and computers are influenced by:



*MULTIPLE RESPONSES ALLOWED
Data: Forrester Research Inc.

Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com



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Olivia Webb - Acct# 82004162341

38 years old. Customer since 1992.

Checking balance \$1,200.

Webb - Acct# 82004162341

38 years old. Customer since 1992.

Checking balance \$1,200.

Married. One child.

Annual salary \$105,000.

Household income \$195,000.

Total household savings \$237,200.

Olivia Webb - Acct# 82004162341

38 years old. Customer since 1992. Checking balance \$1,200.

Married. To her college sweetheart, Chris.

One child. Cute kid named Robb.

A Director of Marketing for tech company.

Annual salary \$105,000. Household income \$195,000.

Total household savings \$237,200.

\$110,000 in brokerage balances; \$125,000 in retirement plan; \$1,200 in checking.

\$1,000 in sister's new catering business.

Spent \$2,000 on money managers last year.

Spent \$250 on ski lift tickets last week.

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**CARLY'S LAST STAND?
FANS AND CRITICS WEIGH IN**

"Carly's last stand?" (Cover Story, Dec. 24) did an excellent job of covering both sides of the story at Hewlett-Packard Co. The only thing missing was a concentration on the impact on employees—namely, those who will lose their jobs with or without the merger. A merged company will surely lead to duplication of effort and massive reductions (I think 15,000 to 30,000 dismissals is unrealistic: more like 50,000). An unmerged company leaves Compaq Computer Corp. in search of a partner—calling Michael Dell—and HP desperate to reduce costs further.

Daniel J. Ruiz
Atlanta

So now, the dubious leader of a venerable engineering company (HP), who can't get traction inside, tries to take over a shaky operation in computer building (Compaq) that has had idle dreams of getting into the consulting business (DEC's client base would have been a start) but has failed to capitalize on original technology whenever it had the chance (selling the Alpha chip). Since when is this a recipe for anything?

Rogier van Vlissingen
Riverdale, N. Y.

Walter Hewlett and company don't realize that HP has only two options: Merge with Compaq in a huge entrepreneurial risk and go after big corporate customers. (IBM makes \$8 billion a year in this market, so there is room for a competitor.) Or, remain stand-alone and sell everything except the printer

business. (Since today's stock prices only printers anyway, this outcome should improve the stock price and provide steady growth.)

The choice is a question of temperament. Walter Hewlett and the other posing stockholders hired Fiori because they were attracted by growth, but they forgot the risks that goes along with it. It seems that William Hewlett and Packard did their best and employees a disservice when they shielded from the risks.

Ray
Framingham,

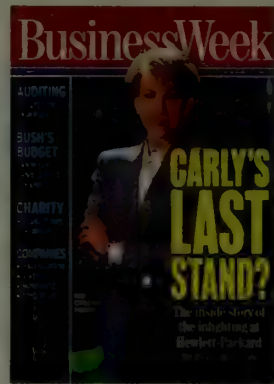
If creativity and vision are hard-wired into a company's genetic code, they skip a generation—a generation in the Hewlett and Packard families. If the co-founders

were alive, my guess is that they be raising a toast to CEO Carleton Fiori right about now, saying: "Visionary leadership still count. Carly, president Jeff Atwood, New Yorktown

As a 20-year HP employee (I work at spin-off Agilent Technologies Inc.), I have many friends there. No one at HP supports this merger, and no one supports Carly. She does not have the confidence of employees. Reggie Fort Collins

MUTUAL FUNDS: WHAT HAPPENED TO LONG-TERM INVESTING?

I would suggest that investors are down in the dumps about the recent performance of their equity mutual funds, relative to money-market



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academician and
relationship marketing
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CORRECTIONS & CLARIFICATIONS

In "The top 25 managers of the year" (Cover Story, Jan. 14), the first name of the president and chief executive of Canon Inc. was misspelled. He is Fujio Mitarai.

"Carly's last stand?" (Cover Story, Dec. 24) should have said that analyst George D. Elling works for Deutsche Banc Alex. Brown Inc., not Credit Suisse First Boston.

In the table accompanying "It could be tech time again" ("Where to invest," Cover Story, Dec. 31), the ticker symbol for Check Point Software Technologies should have been CHKP, and its stock price and p-e ratio \$41 and 32, respectively.

are too focused on short-term performance and are not looking at the big picture ("The mutual fund mess," Special Report, Dec. 17). Think 10 years, not 10 months.

Most successful investors leave it to the professionals by picking good money managers (such as mutual funds). They stick to their long-term plan of staying invested in a portfolio of diversified profitable companies, are patient, and use temporary market declines as an opportunity to buy, rather than sell.

Allan Tonkin
Toronto

Your story states that before the Securities & Exchange Commission adopted its new Names Rule, fund companies "routinely" set up funds to invest in stocks that bore little relationship to the fund's name. In fact, only a tiny fraction of funds have had to make even minor changes to their names or portfolio holdings in response to the new rule, which mainly codified and enhanced longstanding SEC interpretations.

Marco E. Adelfio
Washington

SHOULD CHARLOTTE BEERS BE TEACHING TOLERANCE?

One cannot help wondering whether the mission for Charlotte Beers is overly narrow, if not erroneously targeted ("Charlotte Beers' toughest sell," Government, Dec. 17). McDonald's Corp. and Hollywood have already sold U.S. "belief systems and values" to Middle Eastern people. What Beers can accomplish at best is understanding and tolerance for the existence of alternative beliefs such as ours without imposing those beliefs and values on others.

In fact, unless Beers can accomplish the same objective in the U.S., she will probably fail, because we continue to expect—in business, the arts, and even education—that other cultures will blindly accept our products, our values, our interpretations, our laws, our procedures and our achievements. They will not.

Laszlo A. Pook
Denver

LET'S BAN MILITARY AID TO UNDEMOCRATIC COUNTRIES

"Smart bombs, so why not smart aid?" (Economics, Dec. 24) sounds fine in theory, but there are two problems. First, it sends the message that terrorism works. Pakistan has already had \$30 billion of its debts written off in the wake of September 11. Giving more money would mean that we pay attention and money to those who would rather blow up our skyscrapers. Second, pouring in money does not help the poor, especially in countries where officials who control its distribution are corrupt.

What is needed is a total ban on military aid to undemocratic nations, and putting in place political and economic disincentives geared toward establishing secular democracies, just laws, and unfettered trade. Most of the aid to the Third World goes toward making the rich richer or buying military hardware.

Surendra Kelwala
Livonia, Mich.

NEVER SAY 'SOLDIERS' WHEN YOU MEAN A FEW GOOD MEN

As a retired Marine who spent 20 years suffering the inefficiencies of the supply system, I was overjoyed to read "The Marines learn new tactics—from Wal-Mart" (Defense, Dec. 24).

I cringed, however, when you twice mentioned the difficulties that "soldiers" had with the old supply system. Soldiers are in the Army, but those wearing the globe and anchor are Marines.

William A. McIntyre
San Clemente, Calif.

DEFENDING THE AUDITORS —AND ATTACKING THEM, TOO

"The Big Five need to factor in investors" (News: Analysis & Commentary, Dec. 24) misses the mark with the assertion that "auditors are supposed to uncover secret deals—not let them slide." On the contrary, auditors can dispen-

and figures are disclosed to the management. Generally, secrets don't get recorded in the general ledger for all to see and for auditors to find.

Dan
Madison

Auditor Arthur Andersen has shed its legal responsibilities and professional code of ethics ("Let auditors," Editorials, Dec. 24). At minimum, the partners and other involved on this account should be punished by whichever professional body governs their location—followed by a hasty and public exit from the firm. Only by dealing with this sort of incompetence or dishonesty will auditors have a chance to be viewed as credible. The other large auditing firms should take a hard look at their behavior, as well. I suspect they are tainted, but undiscovered.

Michael
Morris Plains, N.J.

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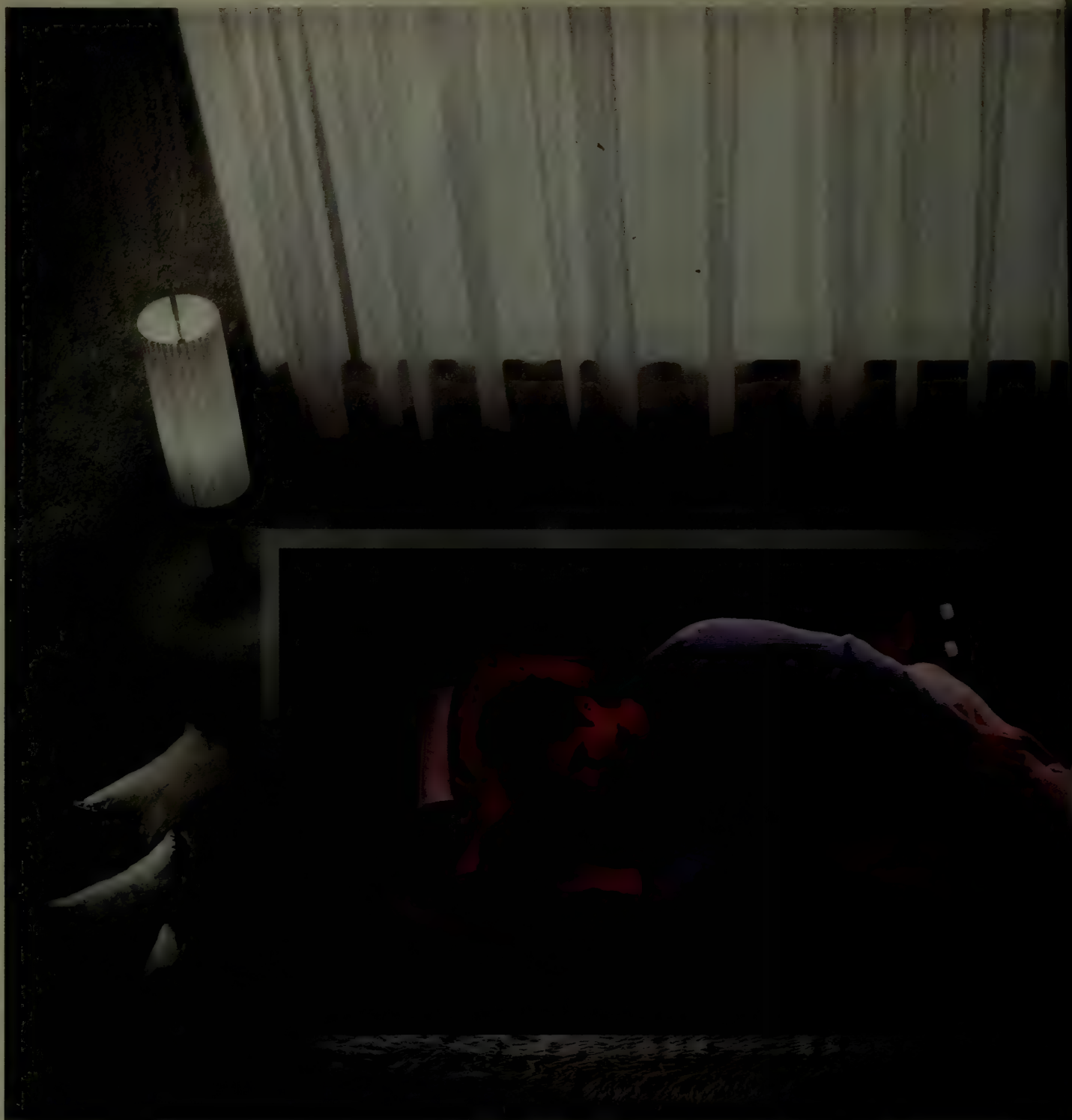
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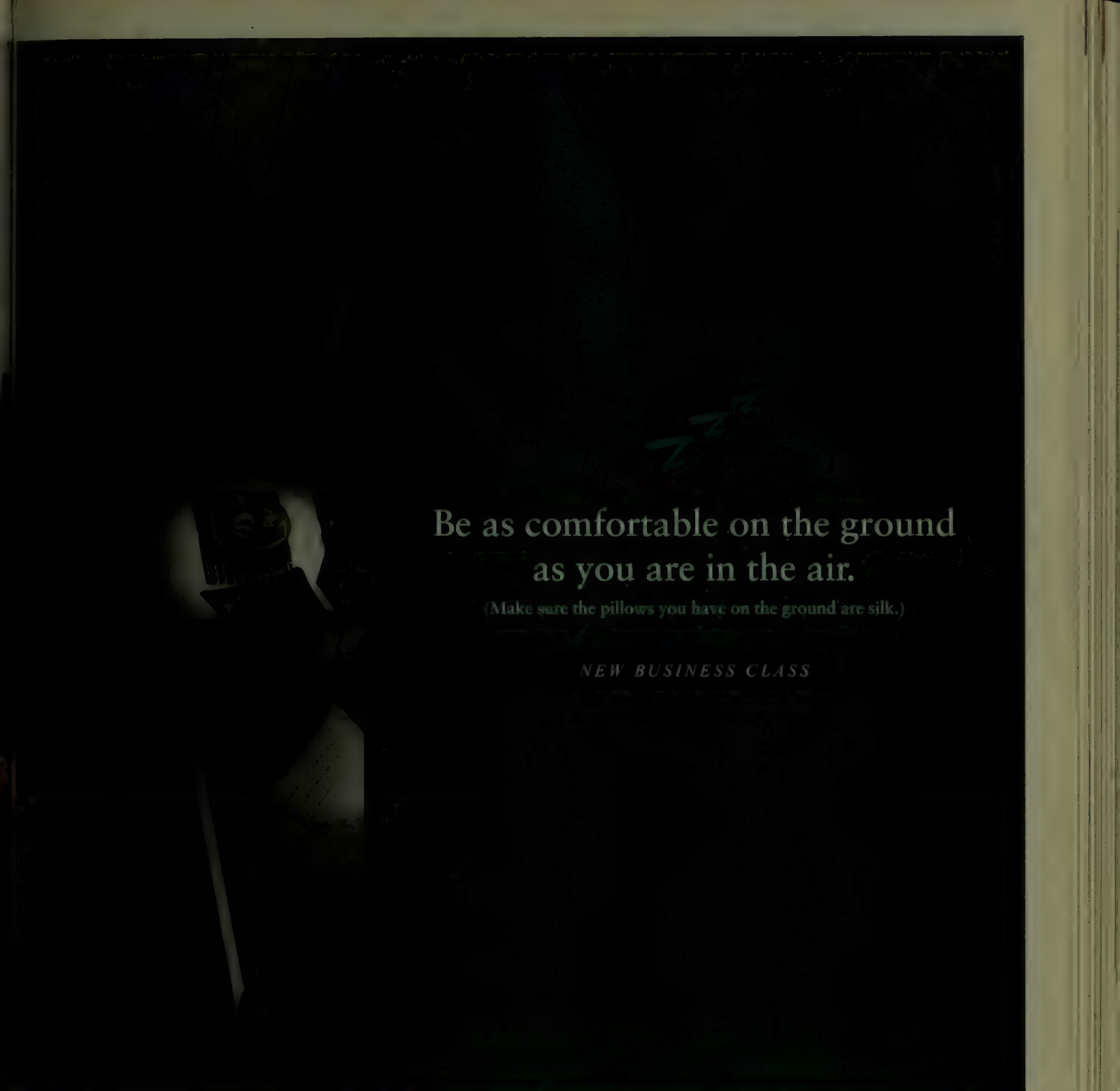


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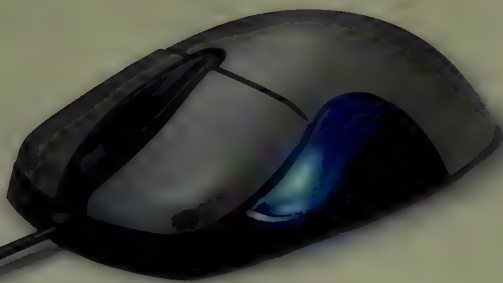
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Where ideas connect

How to tell a cry for help from an act of defiance.

IT'S NOT EASY, and sometimes it takes a professional team to recognize a signal—like unmatched socks.

Amy (not her real name) was a veteran of homeless street life where you steal to survive. She was eight when she was abandoned by her addict mother.

She was hard to be around. Not that she was vicious or violent or anything like that. Instead, she was uncomfortably odd. She made strange faces and hand gestures, had a stilted walk, peculiar mannerisms and an unnerving way of talking too close to your face.

Her deliberately assembled daily costumes (always including her trademark mismatched socks) were over the top. Eight-year-old girls are entitled to wide latitude for fashion peculiarities, but the aggressive nature of Amy's personal dress separated her from the rest of the world. She managed to disturb people before she ever spoke a word, and adults and children alike did their best to avoid her.

Enter Sunny Hills Children's Garden

That was when Amy came to our Group Home Program. Each year, Sunny Hills Children's Garden gives a full spectrum of services to 400 emotionally traumatized children, teens and their families.

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that includes group homes, schools, day treatment. The one common element is a stable, homelike environment.

The breakthrough

For Amy, our answer came when we recognized her behavior as talent struggling to come out. We enrolled her in a local drama program and covered the cost out of our Special Needs Fund. Channeled her "oddities" into acting almost miraculously, the light bulb came on over her head.

She changed her attitude about life. She tried to fit in. She told her teachers she no longer needed to be different and even modified her dress and behavior. She was suddenly ready to do what she had to

to move on from the program and re-enter the world.

She went back to public school. Last May, she graduated from Sunny Hills Children's Garden and is now happily reunited with her relatives after years of separation. Her public school teachers tell her that she gets along just fine. The socks? Pretty much history. As Amy puts it, "I only wear socks that don't match when I feel I don't fit."

A painless way to help 400 other Amys, right now

Just clean out your closet, unmatched socks and all. Bring what you're passing along to our Bargain Box Thrift Shop in San Rafael and while you're there, check out whatever we have for sale.

Yes, there are other thrift shops around, and there may be one closer to you. But none of them can do what we did for Amy.

SUNNY HILLS CHILDREN'S GARDEN

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TITAN OF INDUSTRY AND A BIGOT

On the occasion of his 75th birthday, in 1938, Henry Ford received a medal, the Grand Ser-Cross of the Supreme Order of the an Eagle, from Adolf Hitler. Such Hitler's regard for the carmaker that le time he kept a portrait of Ford in ffice and expressed his admiration in econd volume of *Mein Kampf*. Some is sentiment had to do with Ford's motive achievements, which the er mimicked with a grand plan for an motorways filled with "people's -inspired by the American model." autos aside, the two men also shared *l'ée fixe*: that Jews were responsible he evils of the world.

For much of the 20th century, Henry was America's most notorious anti-te—something that's largely forgot-today. Neil Baldwin, executive dir-or of the National Book Foundation author of *Edison: Inventing the Cen-*, redresses that with *Henry Ford the Jews: The Mass Production of*

It is a provocative, carefully ight history that is far from the dia-suggested by its subtitle. Baldwin's isher had proposed a full biography ord, who was an Edison protégé. Baldwin could not set aside his dis-for Ford. Then came a major media t: the 1997 television broadcast of Holocaust film *Schindler's List*, spon-d solely by Ford Motor Co. The y of this sponsorship inspired Bal-to write a book tightly focused on e he calls "an inadequately told story merican history."

ord wasn't alone in being biased, of se. Baldwin shows that anti-Jewish udes were common in Ford's "tight-ircumscribed world of post-bellum western America."

ut Ford took anti-Semitism a step er than most of his contemporaries personally stoking a powerful pro-anda campaign. His chief instrument

was *The Dearborn Independent*, an ob-scure Michigan weekly that Ford built into a national presence beginning in 1919. The publication carried news of the world, photo displays, and a variety of features. But even though Ford car dealers were required to meet a quota for subscription sales, the paper was \$284,000 in the red by 1920 and circulation was languishing. Ford and his right-hand man, Ernest Liebold, resolved upon an "educational" campaign to build interest. Thus began a series of 91 successive articles slugged "The International Jew: The World's Problem."

The portrait that emerged there, says the author, "fit squarely into a thousand-year-old continuum of Jew hatred." It depicted a group of perpetual aliens, united by race and busy employing their financial sophistication to further a program of world domination. The series was collected and published as a book around the world, with notable success in Germany during the 1920s and '30s. *The Dear-born Independent* also reprinted *The Protocols of the Learned Elders of Zion*, a document purporting to be a blueprint for Jewish world domination that was actually created in the 1890s by the Russian secret police.

Ford's campaign had an unintended consequence. It galvanized an anti-Ford movement among Jewish leaders—including Louis Marshall, a lawyer and president of the American Jewish Committee—who were already beginning to organize around such matters as war relief. Baldwin paints an engaging portrait of these men and their counter-attack, which in time drew support from prominent Christian executives, scholars, and three U.S. Presidents.

By the mid-1920s, Ford confronted

two related crises: His unchanging, no-frills, black-bodied Model T was losing sales to the innovative line of autos produced by a nimble, decentralized General Motors Corp. And Ford's anti-Semitic campaign had left him isolated and under fire. Most important, he was hit with a \$1 million libel suit by agribusiness executive Aaron Sapiro, whom Ford had characterized as part of a malign, international Jewish cabal.

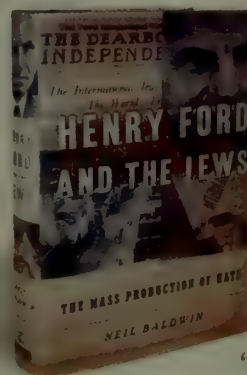
Ford initially responded to both problems by defiantly refusing to change. On several occasions, for example, he was drawn into public screaming matches with his son, Edsel, who argued for styling and engineering changes in the cars. But in the end, says Baldwin, Ford "understood the necessity for a 'clean slate' in both instances." In 1927, he shut down Model T production and began the retooling that would result in the Model A. That same year, Ford issued a public apology for his anti-Semitic words and settled the Sapiro lawsuit. The newspaper then ceased publication.

The apology didn't signify a change in attitude. Ford's private notebooks show that he continued to view Jews as part of an anti-Ford Motor Co. conspiracy, involving "financiers," the New Deal, labor unions, and his major auto competitors. These antipathies, as Baldwin sees it,

"rose and fell in tandem with the chronically uneven fortunes and mis-steps of his automobile business." For the rest of his days, Ford would indulge in an occasional outburst against "the Jews," while demagogues such as radio evangelist/politician Gerald L. K. Smith circulated Ford's anti-Semitic texts. By the 1940s, American Jews were engaging in a near-complete boycott of Ford vehicles, prompting yet another apology from the old man, in 1942. Five years later, he died of a cerebral hemorrhage.

Baldwin ends on an upbeat note, asserting that overt anti-Semitism has been relegated to "the distant fringe" of U.S. life. Even if that's true, no one should be surprised to find the old bigotries popping up elsewhere—stimulated even today by Ford's writings, which are available on the World Wide Web.

BY HARDY GREEN
Green is Books Editor.



HOW HENRY FORD PERSONALLY STOKED AN ANTI-SEMITIC PROPAGANDA CAMPAIGN

BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

iPOD: THE DESIGNERS GOT THIS ONE RIGHT



Apple's digital music player is a cinch to use, has lots of memory—and it looks great

What makes a high-tech product really good? I have been pondering this question since I started using Apple Computer's iPod digital music player several weeks ago. I liked it at first sight, and my affection has grown with use—a reversal of the usual pattern where the more time I spend with a product, the more annoying flaws I discover.

I think the secret of the iPod is simple: an elegant design by the same in-house team responsible for the Titanium PowerBook, a well-executed user interface, and a single-minded focus on doing one job extraordinarily well.

The iPod is a diminutive 6.5-oz. box. It's 4 in. long, 2.4 in. wide, and 0.8 in. thick, a bit bigger than a pack of cards. Inside is a 5-gigabyte hard disk that holds the equivalent of about 100 CDs digitized for high-quality playback and a lithium-polymer battery that easily beats its claimed playing life of 10 hours. iPod's minimalist good looks give it instant appeal, with a face made of clear polycarbonate over white plastic—a hallmark of recent Apple products—and a polished metal back.

But Apple itself has proved that eye candy does not make a good or successful product. The Macintosh Cube, released in 2000, got plenty of oohs and aahs for its sleekness but flopped in the marketplace, largely because its poor design left no room for expansion.

So while looks are important, usability is paramount. Here the iPod overcomes the two biggest liabilities of portable digital music players: capacity and user controls. The 64 megabytes of storage in many music players—about \$50 worth of flash memory at current depressed prices—is barely enough for an hour of play. That assumes recording at 168 kilobits per second, the lowest rate that allows reasonable, though not quite CD-quality, reproduction. Apple opted for a hard drive with massive storage by music player standards. That made the iPod relatively expensive, at \$399, though I believe the capacity to store that much music in a tiny

package makes it an excellent value. The Nomad Jukebox from Creative Labs costs less than \$200, but it's much heavier and bulkier than the iPod and gets only four hours of battery life.

If you offer a device that can hold the equivalent of 100 or so CDs, you have to make it simple for people to find and play the music they want. Here's where iPod shines. Getting music onto the gadget couldn't be simpler. It uses a high-speed FireWire connection to link to a Macintosh. As soon as it's connected, iPod synchronizes its content—music, playlists, and information on artists, albums, and tracks—with the library you assemble on the Mac with the iTunes software that comes with the iPod. Although iPod currently works only with Macintosh, Apple is considering a Windows version.

Meanwhile, a company called iFavor, while, a company called iFavor is readying software that will allow any FireWire-equipped Windows PC to communicate with an iPod.

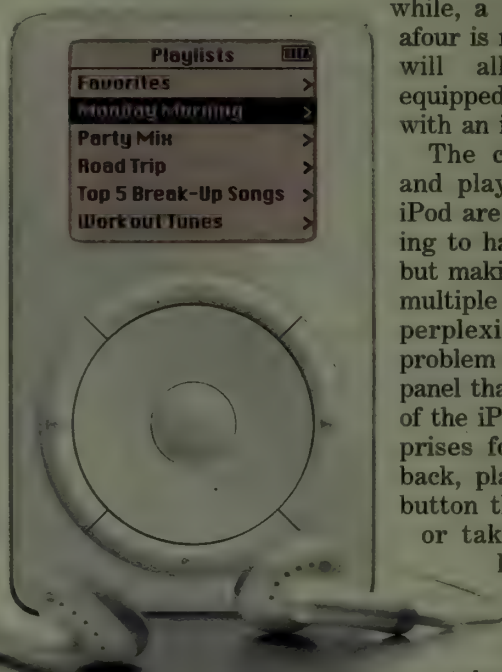
The controls for selecting and playing tunes from the iPod are ingenious. It's easy to have too many buttons, but making one button perform multiple functions can also be perplexing. Apple solved the problem with a circular control panel that fills much of the front of the iPod. An outer ring contains four buttons: for play, back, play/pause, and a button that turns the iPod on or takes you up one menu level.

For example, if you are displaying song information, clicking the back button takes you back to the album or playlist from which the song was selected. In the center is a round button that you

press to select a menu item. Between them is a ring that turns to scroll through menus or just volume once music is playing. You can select music by playlist, artist, album, or individual song.

My only complaint is that the controls respond to a very soft touch, and it's too easy to accidentally turn the iPod on and drain its battery while it is in a pocket or bag. You have to remember to slide the "hold" switch that disables the controls.

I look at dozens of hardware and software products each year. An amazing number of them include serious flaws in design or execution. Sometimes the problems are the result of promises forced by a need to hit a price point, keep weight down, or ensure compatibility. Sometimes, the choices are so bad that all I can do is wonder, "Why did they do it?" The iPod is proof that with enough care and concentration, designers can approach perfection.



JUKEBOX: The iPod holds the equivalent of 100 or so CDs

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BY ROBERT J. BARRO

DON'T BANK ON DEMOCRACY IN AFGHANISTAN



SOLUTION:
The U.S. ought to think about accepting an efficient authoritarian regime that would offer political stability and improve the economy

The military successes in Afghanistan have demonstrated the awesome technological prowess of U.S. air power. However, as the campaign evolves into a nation-building operation, we shall find that our skills in the social and political arena do not match our military talents. The U.S. vision for a postwar Afghanistan relies on the familiar recipes of democracy and massive foreign aid. Unfortunately, neither is likely to work effectively.

The Western ideal for representative democracy involves free, multiparty elections and maintenance of civil liberties. As Aristotle realized, and as the evidence from a large number of countries demonstrates, democracy is almost never sustained in a country that has income and education levels as low as those in Afghanistan. Nevertheless, Washington always recommends democracy, even to the poorest nations, and the results have included such failures as the new Congo and Haiti.

Freedom House's latest ratings place Afghanistan in the lowest categories for electoral rights and civil liberties. This lack of democracy corresponds to the predictions that I would make from the country's economic and social conditions. Given where Afghanistan is today, my statistical analysis implies that the chance a midrange democracy—characteristic at present of countries such as Turkey and Indonesia—will exist five years from now is less than 1%.

A major factor undermining the building of democracy in Afghanistan is low primary school attainment. In 1995, adults had an average of 0.8 years of formal schooling. Only Mali and Niger were lower among the 113 countries for which I have data. Even worse from the standpoint of democracy is the unequal treatment of males and females. In Afghanistan, adult males averaged 1.3 years of primary schooling, whereas females had only 0.3. The male-female ratio of more than 4 is the highest for the 104 countries for which I have these data. The next highest is for Pakistan, which had 1.8 years for males and 0.6 for females. However, poor treatment of women does not apply only to Islamic countries. For example, many non-Muslim countries in Africa have very high ratios of male-to-female schooling.

The lesson for the Bush Administration is that the U.S. ought not to plan for a postwar Afghanistan that has functioning democratic institutions. A more realistic plan would focus on finding, or at least accepting, an efficient authoritarian regime that would provide political

stability and improve economic conditions. Power sharing among local factions may conceivably be part of the picture, but the stability of this arrangement is doubtful for a country like Afghanistan's large number of fragmented ethnic groups.

Ethnic heterogeneity is a source of political instability in Afghanistan. A possible solution, probably too radical for Washington to contemplate, is to partition Afghanistan into several independent countries as a way to achieve greater homogeneity within each political division. However, the transition to multiple states can itself promote violence, as is clear from former Yugoslavia.

Foreign aid is a critical issue as well. Given the dire economic conditions in Afghanistan, a large amount of short-term assistance makes sense. The problem is that short-term help is likely to evolve into long-term aid, which history has not contributed to economic development. Instead of alleviating poverty or promoting economic growth, foreign aid has tended to sustain large, corrupt governments.

William Easterly argues in his recent book *The Elusive Quest for Growth*, that the problem is not foreign aid per se, but rather the way in which aid programs relate to past performance. Basically, to qualify for American aid, a country has to mess things up. The reward for success is that a country "graduates" and becomes ineligible for future aid. The currently fashionable development programs work essentially in the same way. Easterly argues that the policy formula should be reversed: "As countries' incomes rise because of their favorable policies for economic growth, aid should increase in matching fashion." Unfortunately, aid givers are unlikely to adopt this long-headed approach. In fact, Easterly's own recommendation for publicizing this and other radical reform proposals was to be encouraged to leave his research position at the World Bank.

The likelihood is that entrenched foreign aid will become part of Afghanistan's problem rather than a piece of the solution. We can already see how warlords are stealing much of the grain being sent, bolstering their position in the country. This will only get worse over time.

Someday, perhaps, we will become as long-headed about the war on world poverty as we have become about the war on international terrorism. But for now, we seem to be relying on the soft weapons of democracy and foreign aid and these policies have failed time and again.

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).



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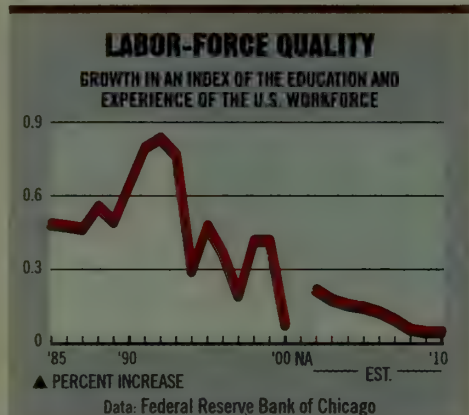
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EDITED BY PETER COY

BOOMERS: A HARD ACT TO FOLLOW

Labor-quality rises may taper off

Quality of labor is an important factor in U.S. productivity growth. According to a new study by Daniel Aaronson and Daniel G. Sullivan, senior economists at the Federal Reserve Bank of Chicago, the improvement in labor quality between 1987 and 1994 contributed nearly 0.4 percentage points a



year to overall productivity. From 1995 through 2000, quality rose more slowly, and the authors predict it will slow even more this decade.

Aaronson and Sullivan used wages as an indicator of labor quality, assuming that in a competitive job market, people are paid what they're worth. While acknowledging that's not always the case, they say "an enormous number of empirical studies" have found it to be a useful approximation. To isolate the effect of labor quality on wages, they looked at how wages are correlated with education and work experience, using data from the Labor Dept.'s monthly Current Population Survey since 1964.

The Fed economists found that labor-quality patterns were influenced by the huge baby-boom generation. During the late 1970s and early '80s, labor quality began to rise as boomers entered the workforce. Although inexperienced, boomers were better educated than the workers they replaced. As the boomers gained experience, the improvement accelerated. Between 1987 and 1994, labor-quality growth averaged 0.6%.

The economists also confirmed the theory that labor quality gets worse when the economy is booming and better when there's a recession. That's be-

cause workers with less experience and education are pulled into the workforce in good times and they are the first to get pink slips when the economy falters. Improvements slowed during the boom years of the late 1990s and probably rose in the recession year of 2001, for which data are not yet available.

As boomers begin to move beyond their peak earning years, labor-quality growth will take a big hit. People in their early 50s earn the highest wages, so they are assumed to have the highest labor quality. By 2010, many boomers will be past that sweet spot, so their labor quality will presumably be lower. The Gen Xers who replace them in the prime years are fewer in number. Overall, Sullivan and Aaronson forecast labor-quality growth will drop to less than 0.1% by 2010. That means productivity and output could grow up to 0.2 percentage points a year more slowly than they would have if labor quality had continued to improve at its 1990s pace.

By James Mehring

MORE BASKETS TO PUT EGGS IN

Spread your risk across 50 nations

Investing in foreign stock markets is a good way to make the returns on your portfolio less risky—through diversification. But while globalization has made it easy to buy foreign stocks, it has also made major securities markets around the world more likely to move up and down together, reducing the benefits of such diversification. In 1940, you could eliminate roughly three-quarters of the volatility in your investment portfolio by splitting it evenly among British, French, German, and U.S. stocks, compared with investing it entirely in just one of those countries. Today, such action would reduce your portfolio's volatility by only about 30%, according to a recent study, *Long-Term Global Market Correlations*, by William N. Goetzmann and K. Geert Rouwenhorst, finance professors at Yale School of Management, and by Lingfeng Li, a PhD candidate in economics at Yale University.

Fortunately for investors, as the world's major capital markets have become more tightly linked, fringe markets have cropped up, offering new opportunities for diversification. Since the 1960s, the number of stock markets open to global investors has expanded from around 30 to around 50. In 2000, a

portfolio distributed equally among available stock markets had 70% volatility than one concentrated in a single market—a result nearly as good as investors could get from the four major markets in 1940.

By Margaret F.

WIGGLE ROOM FOR EURO BOSS

Part-timers give them flexibility

Euro-zone countries are often criticized for laws that make it costly to hire and difficult to fire workers. Critics complain that they can't expand as quickly in good times or contract as swiftly in bad times as their U.S. counterparts. So profits have been lower and a smaller percentage of the working-age population has been employed. "That led to lower consumer spending and slower economic growth," says Paolo Monticelli, co-chief of euro-zone economics at Deutsche Bank in London.

Slowly, however, flexibility is creeping into European labor markets. Michael Saunders, chief European economist at Schroder Salomon Smith Barney in London, notes that the number of employees working part-time or on fixed-term contracts has risen sharply. In Germany, for instance, part-time jobs represented 17.6% of total employment in 2000, up from 13.4% in 1990, according to the Organization for Economic Cooperation and Development. Economists estimate the proportion continued to rise last year (table). Because part-time and temporary staff can be laid off more easily than full-time workers, companies are more likely to hire them in the first place. In Germany, as a result, Saunders notes, the labor force participation rate—the ratio of the total labor force to the working-age population—rose by more than two percentage points, to nearly 69%, in the years to 2000.

To be sure, the big captains of industry would still like U.S.-style freedoms to hire and fire full-time employees. In the meantime, they are eagerly using the greater flexibility that has recently come their way.

By David Fairlamb

EUROPEAN PART-TIME EMPLOYMENT AS A SHARE OF TOTAL EMPLOYMENT

COUNTRY	1990	2000
GERMANY	13.4%	17.6%
FRANCE	12.2	14.2
ITALY	8.8	12.2

*Economists' estimates
Data: Organization for Economic Cooperation & Development



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A close-up, high-contrast photograph of a person's face, focusing on their eyes and lips. The eyes are dark and looking directly at the camera, while the lips are full and painted with a dark red lipstick. The image is split horizontally by a dark blue band containing white text.

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AMES C. COOPER & KATHLEEN MADIGAN

ONE MORE RATE CUT—MAYBE. BUT THEN WHAT?

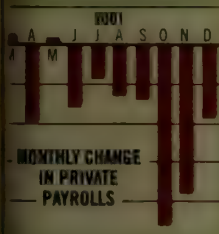
Rising productivity and weak labor markets will delay Fed tightening

U.S. ECONOMY

In one of the most aggressive policy moves ever, the Federal Reserve cut the federal funds rate from 6.5% at the beginning of 2001 to 1.75% at the start of 2002—another cut on Jan. 30 cannot be ruled out. Now, as this massive stimulus is fueling prospects for recovery, a key question has cropped up: When will the Fed begin to raise interest rates?

The answer is not easy. Policymakers are unlikely to be in any hurry to reverse course. A subpar recovery, rising unemployment, declining inflation, excellent productivity growth, and plenty of production slack will keep the Fed on the sidelines for a long while. Recent speeches by Fed officials strongly support this view. Even so, with the funds rate now below inflation, implying a negative real rate, monetary policy is exceptionally accommodative to economic growth. At some point, the Fed will want to nudge interest rates back to a level that gives policy a more neutral stance.

LAYOFFS EASED UP IN DECEMBER



THOUSANDS OF JOBS
Data: Labor Dept., DRI-WEFA

Investors, well aware that Fed actions affect stock and bond prices, are already anticipating a reversal in monetary policy. Yields on 2- to 10-year Treasury securities are up substantially from November, mainly reflecting expectations that the coming recovery will cause the Fed to lift rates, along with prospects for increased Treasury borrowing and budget deficits. Plus, contracts on interest-rate futures reflect bets that the Fed will begin to tighten as early as summer and that rate hikes could total more than one percentage point by yearend.

Those expectations sound a little too aggressive, however, given the outlook for rising productivity and declining inflation. Most important, history shows that the Fed does not tighten until the jobless rate begins to decline. In this recovery, that may not happen until late next year. As a result, the Fed may not begin to lift rates until the fourth quarter.

GOOD NEWS

on the labor front is that the December employment report suggests that the worst of job losses are probably over (chart). Private-sector layoffs fell by 187,000 last month, less than the 465,000 lost in October and the 382,000 shed in November.

Also, manufacturers sharply increased their workweeks and overtime. That's a typical recovery event: When demand first begins to strengthen, factories work their existing employees for more hours before hiring new workers. So December's longer workweek suggests a firmer tone to the factory sector (chart).

Still, don't expect much from the job markets. Companies will probably choose relatively cheap capital over more expensive labor as a means of boosting output and profits. That's why payrolls will not grow rapidly in the early stages of the recovery, and the jobless rate, which rose 0.2 percentage points in December, to 5.8%, is destined to rise further and then be very slow to come back down.

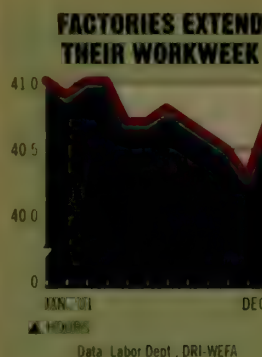
Weak labor markets are another reason the Fed will be less apt to raise rates. Of course, the jobless rate is politically sensitive. But more important, consumers will not provide the same thrust they usually do in a recovery. First, household spending did not fall off as sharply as it usually does in a recession, leaving less pent-up demand to be filled as better times emerge. Second, this year will see the pendulum swing back toward corporate profits and away from wages.

Remember that profits' share of national income surged in the mid-1990s—as business investment spurred productivity growth and thus corporate earnings—and that labor's share of income ebbed. By the late 1990s, the trends had reversed: Unsustainably high economic growth tightened labor markets. That lifted household income but also raised costs and squeezed profits.

NOW, IT'S CORPORATE AMERICA'S TURN

to gain ground at the expense of Household America. Continuing cuts in variable pay and bonuses, along with the sharp cutbacks in contingent workers, are all reflections of this shift. And as demand picks up this year, companies will restore their profit margins by boosting productivity, not payrolls.

Given the spread of technology in the economy, it probably comes as little surprise that productivity growth is holding up phenomenally well in this recession. And it will grow even faster as the recovery gains speed. That resilience was especially true in the



Data: Labor Dept., DRI-WEFA

fourth quarter of last year. Official data will not be available until Feb. 6, but productivity appears to have posted a solid gain. Hours worked last quarter fell at a 3.9% annual rate. Even if real gross domestic product fell 2%, as is generally expected, productivity would still post a gain in the 1% to 2% range.

In the first three quarters of this recession, productivity is on a track to grow at a 1.9% annual rate. That's on a par with the 1.8% pace during the same period of the recessions of the 1950s and 1960s, a time of generally high productivity growth. And the trend is in sharp contrast to the recessions from the mid-1970s to the early 1990s, when productivity fell off sharply from its long-term growth trend. In that era's three recessions that lasted at least a year, productivity declined at an average annual rate of 0.9% during each downturn's first three quarters (chart).

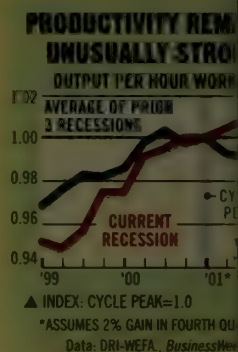
THE UPBEAT PRODUCTIVITY OUTLOOK will be central to the Fed's way of thinking in 2002, chiefly because Fed Chairman Alan Greenspan remains a key proponent of that view. Moreover, in the policymaking Federal Open Market Committee's annual rotation of Fed district presidents, two presidents who openly opposed aggressive rate-cutting this past summer will rotate off the committee.

Rotating onto the FOMC will be Dallas Fed President Robert D. McTeer Jr., perhaps the strongest advocate

of the productivity revolution. One of the less enthusiastic proponents of the strong-productivity story, Fed Governor Laurence H. Meyer, chose not to reappointment. Plus, the board will include two new governors, who typically don't make waves and are likely to vote with the chairman. On balance, the policy committee appears to be a tad more dovish than the 2001 version.

Indeed, inflation hawks will have little to squawk about this year. Not only will productivity keep down labor costs, but price pressures from other sources will be almost nil. The considerable slack in production capacity, the steadfast strength of the dollar, and a global recovery that will be slow to develop mean that inflation simply can't get started.

Investors obviously have a huge stake in the belief that strong productivity gains will keep inflation low, lift investment and profits, and allow the Fed to keep interest rates low. That forecast is clearly built into current stock-market valuations. If that belief is wrong, it will become apparent as the recovery develops. Likely, the party will start slowly, and the Fed will keep the punchbowl generously filled.



GERMANY

BANKING ON A RECOVERY AFTER MIDYEAR

At least for now, Germany's government is sticking with an upbeat forecast of a 1.25% gain in real gross domestic product in 2002. But private economists expect 1% or less. And while the difference seems small, slower growth has big implications for the euro, job prospects, and fiscal finances.

Germany's real GDP fell in the third quarter and likely shrank further at yearend. The December purchasing managers' index slipped, with production, inventories, and jobs falling. November factory orders rose, but domestic bookings alone fell for the third month in a row. And the labor markets continued to deteriorate in November. The

jobless rate stayed at a high 9.5%, as the number of unemployed rose to 3.9 million, the largest amount in nearly two years.

Although the recent data are dismal, German executives are optimistic about a second-half recovery. Specifically, they expect exports to strengthen, but this implies other nations will turn around before Germany does.

The government is also hopeful about the second half. In an interview, Economics

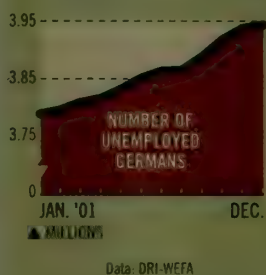
Minister Werner Müller said second-half demand would be lifted by lower taxes, increased family benefits, and low inflation. That's why the Finance Ministry is standing by its growth forecast of

1.25%. But private economists, including the government's outside economic advisers, known as the Five Wise Men, forecast real GDP growth of 0.7% in 2002.

The fear that Germany will undershoot its forecast has put downward pressure on the euro. After the jobs data were released on Jan. 9, the euro slipped again against the U.S. dollar. Slower growth may also lift Germany's fiscal deficit closer to the 3% of GDP ceiling imposed by the euro-zone policymakers.

In addition, a magazine poll found that unemployment was a major concern for 55% of Germans, up from 37% in 2001. Another 38% were worried about the economy, twice the rate of a year ago. These increased jitters could delay any meaningful rebound in consumer spending this year.

THE JOB MARKETS ARE LOOSENING UP RAPIDLY



NATIONWIDE

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Ground

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FedEx
Ground

THE MORTICIANS MOVE IN

Lawyers, investment bankers, and accountants could walk away with as much as \$300 million

When Houston-based energy company Dynegy Inc. pulled out of a deal to buy troubled Enron Corp. last Nov. 28, attorneys at the firm Weil, Gotshal & Manges knew they had to act fast. Enron's stock was plunging below a dollar, its credit rating had collapsed, and creditors suddenly had the right to call in loans and seize buildings, pipelines, and other assets the company had put up as collateral. "We were hearing rumors about unilateral actions by creditors," says Weil Gotshal partner Martin J. Bienenstock. "And we wanted to stop that."

So the law firm, which Enron retained in October, threw everything it had into the case. Dozens of lawyers worked around the clock preparing a petition for Chapter 11 protection. When they finished four days later, they immediately filed electronically with bankruptcy court—even though it was 5 a.m. on a Sunday morning. By acting so quickly, the lawyers claim they kept Enron's creditors from tearing the company apart.

They've been busy ever since. Indeed, Enron's misfortune is proving to be Weil Gotshal's blessing. By the time the bankruptcy is over, the firm could rake in as much as \$30 million in fees. More than a dozen other law firms are also on the case. And the attorneys are joined by a small army of investment bankers, such as Blackstone Group, which is charging \$350,000 a month, plus a \$35 million bonus if the company reemerges from Chapter 11. All in all, the various hired guns managing history's largest bankruptcy will earn fees of as much as

\$300 million or more.

They are under a tight deadline and operating in a highly charged environment. On Jan. 9, the situation became even more electric as the Justice Dept. confirmed that it has opened a criminal investigation into the fall of Enron. That is likely to be a serious distraction for the lawyers,

bankers, and accountants, but for now, they are focused almost exclusively on auctioning a majority stake in Enron's highly successful trading unit, set to be completed on Jan. 10. A quick sale is seen as critical because the unit is rapidly losing out to more stable rivals. "The idea is that this is like ripe fruit," says one attorney close to the case. "If it doesn't move quickly, it will rot."

These are boom times for the morticians of the business world. It is a diverse group that also includes accountants and turnaround specialists—management consultants, such as Jay Alix & Associates,

that specialize in rescuing insolvent companies. Last year, 255 publicly traded companies filed for bankruptcy, breaking the prior record of 176 in 2000, according to BankruptcyData.com. "It's as if I get up in the morning and want to get rich off this," says John Despins, a partner at Milbank, Hadley & McCloy and lead counsel for Enron's creditors. "But all of us have work right now."

Unlike prior downturns, where bankruptcies have been concentrated in troubled industries such as airlines and

**ENRON
WATCH**

urrent wave of failures is unusually
l. It runs across a wide swath of
esses, including Pacific Gas & Elec-
tricity, Excite@Home, and Fruit of the
Loom. Even though the debtors are
diverse than ever, the bankruptcy
process is dominated by a small club.
There are perhaps a dozen law firms—
even fewer investment banks—with
armies of experts at a big company in
the needs on short notice.

So far, the Enron case has attracted
all of the big guns. Among law firms,
Weil Gotshal has the most prominent
bankruptcy practice. Milbank Tweed is
a leading specialist in the represen-
tation of creditors.

Other top bank-
ruptcy shops in-
clude Wachtell,
Lipton, Rosen &

who would be interested in these assets.

Given the company's complexity and
potential legal problems, most observers
are betting it will take Bienenstock twice
as long as he'd like to bring Enron
around. That could be bad news for the
company, since creditors tend to push
harder for liquidation the longer bank-
ruptcy proceedings drag on. "I'd put his
chances [of a successful reorganization] at
about 30%," says University of Houston
Law School Dean and bankruptcy pro-
fessor Nancy Rapaport. "At some point,
creditors might say, 'You've liquidated
some, we think you should keep going.'"

While Weil Gotshal has had some no-
table successes—including the 1990 re-
structuring of Federated Department
Stores—it also has plenty of critics. The
firm's bruising tactics have earned it the
nickname "We'll Getcha and Mangle Ya"
among rivals. It has also occasionally run
into trouble with bankruptcy trustees. In
1992, an employee of the U.S. Trustee
in Connecticut accused the firm of padding
its bills in a case involving gunmaker

Colt's Manufacturing Co. Weil denies it,
and no penalty was imposed. In

1994, though, the firm was pe-
nalized \$1 million for not
reporting conflicts in the
bankruptcy of Leslie Fay
Cos. The trustee in that case
was none other than U.S. Dis-
trict Judge Arthur J. Gonzalez—

the man hearing the Enron bankrupt-
cy. But the two sides have met on cases
with no sign of ill will since.

Standing side by side with the attor-
neys in the Enron bankruptcy are the in-
vestment bankers. While not nearly so
numerous as the lawyers, they tend to
make more money. Indeed, restructur-
ing work is fetching larger fees than ever
because of the difficulty of valuing and
selling bankrupt assets. Since many big-
ger investment banks dropped out of the
bankruptcy business when the economy
picked up in the early 1990s, it is now
dominated by boutiques such as Black-
stone, Lazard, and CIBC World Markets.

The auction of Enron's trading unit
has been largely handled by Blackstone.
Boutique shop Batchelder & Partners
Inc., meanwhile, has poured over the
books in search of overlooked assets. Be-
cause of the pressure to move quickly, it
has been grueling. "We've been heavily
involved on a full-time basis, which in-
cludes weekends," says Steven M. Zelin,
a senior managing director at Blackstone.
For Enron's undertakers, that's likely to
continue for some time.

*By Dan Carney in Washington, with
Emily Thornton in New York and bu-
reau reports*

WHERE THE MONEY IS GOING

*The biggest bankruptcy
in history
is making a small industry
of advisers rich*

ENRON'S LAWYERS

The oil giant has
turned to Corpo-
rate America's
leading bankrupt-
cy counsel, Weil,
Gotshal &
Manges. The firm
charges \$700 per
hour for top guns
and could
ultimately earn up
to \$30 million.



**GOTSHAL'S
BIENENSTOCK**

CREDITORS' LAWYERS



**MILBANK'S
DESPINS**

Milbank, Tweed,
Hadley & McCloy
dominates the
business of
representing
creditors and
is expected to
earn \$15 million
to \$30 million
on the Enron
case.

INVESTMENT BANKERS

Blackstone Group,
Enron's lead
banker, will get
\$350,000 a
month, plus a \$35
million "success
fee" if it accom-
plishes a success-
ful reorganization.
It's backed by
Batchelder & Part-
ners, which is
making a \$15 million success fee,
or \$375,000 a month if the reor-
ganization attempt fails.



**BLACKSTONE'S
ZELIN**

ACCOUNTANTS

While Enron is in bankruptcy,
Cap Gemini Ernst & Young, as
well as other firms, will advise the
parties to the bankruptcy. Fees are
yet to be determined, but accoun-
tants often earn up to \$200,000
a month.

Data: Southern District of NY Bankruptcy Court, BusinessWeek

COMMENTARY

By Louis Lavelle

ENRON: HOW GOVERNANCE RULES FAIL

One of the mysteries of Enron Corp.'s fall from grace is how an audit committee chock full of talent could have been blind to the company's financial sleight of hand. So far, speculation has centered around the apparent failure of Enron's auditors, Arthur Andersen LLP, to alert the audit committee to the problem until very late in the game. But the truth is, the audit committee deserves much of the blame for Enron's collapse—and the corporate governance movement deserves much of the blame for the Enron audit committee.

Whatever its flaws, the committee followed all the rules laid down by federal regulators, stock exchanges, and governance experts regarding director pay, independence, disclosure, and financial expertise. Enron collapsed in large part because the rules didn't accomplish what the experts hoped they would. For example:

- Paying directors with stock may have aligned their interests with shareholders', but it's just as likely to have created a motive for not asking the tough questions.

- Disclosure rules may have alerted investors to the fact that one audit committee member had a potential conflict of interest, but not that two others did as well.

- The Enron audit committee may have been exactly what the stock exchanges had in mind in December, 1999, when they required that members demonstrate financial know-how—but the expertise may have been out of date following the changes Enron went through in the 1990s. In any case, it didn't help the committee make sense of Enron's tangled finances.



ENRON WATCH

Bottom line: It may be time to rethink the rules.

Certainly there was nothing unusual about the Enron directors' heavy stock ownership. Boards in general have bought into the argument by governance experts that directors should get paid largely with stock to make sure they act in the best interest of shareholders. Of the top 200 companies, 99% pay directors with stock, up from 81% in 1995. And 62% of director pay comes in equity, up from 24% in 1995, according to pay consultant Pearl Meyer & Partners.

Clearly, stock is king. But should it be? Auditors are prohibited by the Securities & Exchange Commission from owning stock in client companies precisely because of its potential to corrupt. Yet audit committee members,

like all directors, are typically required to be presumably honest. The six audit committee members owned nearly 1 million Enron shares worth more than \$7 million as of Feb. 15—shares that surely would have increased in value had Enron not forced management to clean up the books. Some of the committee members' balance-sheet payments were

The committee's public explanation of its finances suggests that the shares, by making shareholders the directors' tool, did the opposite of buying their silence. They greed blind them. It's very possible that M. Nash, co-founder of the National Association of Corporate Directors, is one lawsuit alleging that Enron's audit committee

sold 17.3 million shares for \$1.5 million to an unsuspecting public who believed the financial statements later revealed to be pure fiction. The audit committee members either declined to comment or not return calls. But Enron's board since 1999 approved the controversial partnerships, controls, and acted "quickly" to restate earnings when the problems became apparent, albeit after Enron's shares plunged and questions about the partnership

It's hard to argue that directors shouldn't own shares at all. Sales by directors for the duration of their terms would motivate them to preserve a company's long-term value instead of taking a see-no-evil approach to oversight.

If the stock didn't blind the audit committee members, the

the company may have. It's that governance critics anticipate what's troublesome is that sure rules required Enron to own only one of those ties: did Wakeham's \$6,000-a-month contract. One would need to be afield from Enron's security to learn from the University that Enron, Chairman Kenneth and their foundations had \$150 to the school's M.D. Anderson Center since 1999. That's former President John Mendelsohn an Enron director. Also paid by Enron: \$50,000 that the and the Lay family foundation George Mason University's Center, where Wendy Lee has been head of regulatory since she joined the center in 1998 and its employees also financial contributions of more \$100 to her husband, Senator Phil Gramm (R-Tex.), since she became a director in 1993. Finance experts say the audit's lack of independence it less inclined to management.

are humans," says I. Koppes, former counsel for the California Employees' Retirement System. "You're not want to rock the the very least, in are entitled to half the committee financial ties to the The SEC should likely to propose a sought by institutional investors, requiring disclosure of all financial directors—personal, business, political and topic. Using that about 30% of the 200 companies by the Investor Responsibility Research have audit committees are less than 100% ent.

the few areas Enron disclosed a information was inications of board On paper, the audit was as qualified as than fulfilling the requirement by stock that members

The audit committee followed all the rules—but it let shareholders down

demonstrate financial literacy. Committee Chairman Robert K. Jaedicke was a Stanford University accounting professor for 30 years. Ronnie C. Chan and Paulo V. Ferraz Pereira are executives. Mendelsohn runs a university cancer center. Gramm is an economist. And Wakeham belongs to the House of Lords.

Yet, as a group, they were apparently unable to decipher the tangled web of off-balance-sheet deals that effectively hid Enron's debt and inflated its earnings. Jaedicke, 72, has been retired for more than a decade. Some have

suggested privately that he may not have been up to speed on the complex financing strategies that were so integral to Enron's rapid transformation from an energy pipeline company into a trading outfit. Some governance experts now conclude that meeting the textbook definition of financial literacy is not a guarantee that directors understand sophisticated financial instruments.

The truth is that the ideal audit committee envisioned by the rules governing independence and financial literacy is to some extent a mythical beast. Big global companies are now so complex that insiders are often the only people who truly understand them. But only outsiders have the independence to rein them in. And many boards don't exercise the diligent oversight companies need. A new survey of audit committees at 50 U.S. companies by Joseph V. Carcello, an associate accounting professor at the University of Tennessee at Knoxville, found they typically meet just three times a year, only two-thirds

bother to review their companies' internal audits, and fewer than one in five have unrestricted access to company records. Enron's committee met five times in 2000; the company's proxy is unclear on whether it reviewed the internal audit or had unfettered access to records.

If nothing else, the Enron debacle should occasion some soul-searching on the part of federal regulators and stock exchanges that make the governance rules. It would help if audit committees were required to convene meetings more frequently, conduct an annual review of the internal audit, and educate members in more than just the balance-sheet basics. "Ultimately," says Alan Cleveland, counsel to the New Hampshire Retirement System, an Enron shareholder, "what it comes down to is what goes on not only in the boardroom but in the minds of these outside directors." For governance to work, directors need to understand that their job is to keep tabs on management—not simply show up.

Lavelle covers management issues from New York.

COSTLY LESSONS

Here's where the Enron board's audit committee came up short and some possible fixes.

DISCLOSURE Companies are required to disclose some, but not all, financial ties with directors. Critics have cited conflicts at Enron, which correctly disclosed its consulting contract with one audit-committee member, but not the charitable contributions made to affiliated organizations of two others.

SOLUTION: Disclose all financial ties.

KNOW-HOW Audit-committee members must demonstrate basic financial literacy, and one must have financial expertise. Enron's committee included an accounting professor, an economist, and two businessmen. But they apparently didn't understand the risks in some of the company's complex limited partnerships.

SOLUTION: Committees should have to meet more often, review internal audits, and get industry-specific finance training.

COMPENSATION Most companies pay directors largely in stock to align their interests with those of shareholders. But at Enron, where some directors sold shares near the August, 2000, high, large holdings may have made directors less willing to ask tough questions.

SOLUTION: Pay in stock, but ban stock sales as long as directors are on the board.

INVESTIGATIONS

HOT POTATO: HANDLE WITH CARE

Playing politics in the Enron probe could burn either party

When Enron Corp. tumbled into bankruptcy, it put thousands out of work and drained billions from investors' portfolios. But the collapse of George W. Bush's top corporate backer may have a silver lining for one group: the Democrats. "Politically, this is a gift from heaven," says Larry Makinson, a senior fellow at the nonpartisan Center for Responsive Politics.

Of course, Senator Joseph I. Lieberman (D-Conn.) took care not to gloat when he announced that his Governmental Affairs Committee would investigate Enron. "This is a search for the truth, not a witch hunt," Lieberman said on Jan. 2. "The questions that need to be asked and answered about what happened to Enron are of great public—not partisan—interest."

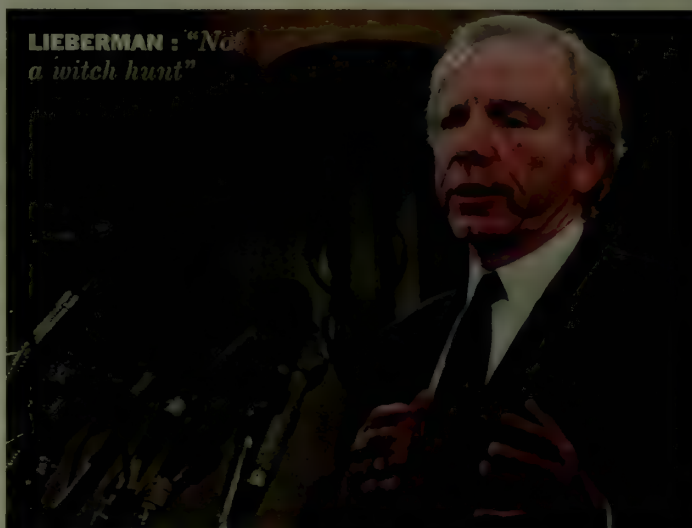
Carefully chosen words, especially coming from the man who could be Bush's top challenger for the White House in 2004. And for good reason: The Enron debacle is a minefield. Dems will attempt to make Enron a case study in cozy GOP relations with Big Business and insensitivity to working people, while putting a dent in the President's armor. They'll charge that Enron's generosity to Republicans, who pocketed 73% of Enron's \$5.77 million in campaign donations in the past decade, bought looser regulation of energy deals and a blind eye toward accounting conflicts.

Lieberman will be under pressure from the party leadership to rake the Republicans over the coals. That strategy would score points with the liberal Democratic base he must cultivate if he wants to challenge Bush in 2004. But the longtime pro-business Democrat risks looking like an opportunistic partisan if he moves too aggressively.

"This wasn't Whitewater. This was bad business," warns one Democratic lobbyist. "If they try too hard to connect the dots to the Administration, they might jeopardize the credibility of the whole hearings."

It'll be a hard balance to strike, even for a pol like Lieberman, who has cultivated a persona of high-mindedness.

**LIEBERMAN: "No
a witch hunt"**



ENRON: LINING UP ON CAPITOL HILL

DEMOCRATS

Senator Joseph I. Lieberman (Conn.) His Governmental Affairs panel will look for regulatory weaknesses that abetted Enron's rise and fall.

Senator Carl Levin (Mich.) He will lead the attack. His permanent subcommittee on investigations will be aggressive and partisan.

Representative John D. Dingell (Mich.) Longtime chair of Energy & Commerce panel, now in minority, is likely to be vigorous in attacking Enron and the SEC.

REPUBLICANS

Senator Phil Gramm (Tex.) His close ties to Enron have kept the Banking Committee, which Gramm once chaired, on the sidelines.

Representative W. J. "Billy" Tauzin (La.) An in-depth probe by his Energy & Commerce panel is giving the GOP cover—and time to regroup.

Representative Michael G. Oxley (Ohio) His Financial Services panel was first to hold hearings, where both parties vented outrage.

Lieberman criticized President Clinton for his dalliance with Monica Lewinsky and split with his party during investigations into the 1996 fund-raising practices of Clinton and Vice-President Al Gore. That virtuous image helped him land a spot on Gore's 2000 ticket. Says Charles E. Cook Jr., editor of the nonpartisan

Cook Political Report: Lieberman is "good at appearing as though he's earnestly seeking the truth rather than seriously exploiting a situation—even if he is seriously exploiting a situation."

But many Democrats smell GOP Representative Henry A. Waxman (Calif.), the top Democrat on the Government Reform Committee, leaked details on Jan. 8 of Enron's reshaping the energy policy drafted year by Vice-President Dick Cheney. With the Justice Dept. opening a criminal investigation, the Labor Dept. Securities & Exchange Commission conducting civil probes, and five congressional committees holding hearings,

name Enron and its relationship to the Bush family are expected to remain in the headlines—and that's something that pleases your average Democratic strategist," says Kim Iversen, chief political analyst for Lehman Brothers Inc.

Republican leaders aren't counting on Democratic restraint. GOP-controlled House is launching its probes, in part to insulate Republicans from charges favoring the company. And Enron will try to capitalize on both parties' fear of a political backlash. "The policy issues that this tragedy raises should not be lost in a partisan food fight," Enron's outside counsel, Robert Bennett, says.

Business lobbyists are particularly concerned that losses from Enron's 401(k) plan—which have cost many workers—lead to stiff

regulations. "When you're dealing with trillions of dollars and the retirement prospects of an aging nation, political lines get drawn quickly," says James A. Klein, president of the American Benefits Council, which represents employers and pension managers.

Congress' full-throated pursuit of Enron should provide fascinating political theater. But as elections draw near, sides must avoid overplaying their hand lest they get booed off the stage.

By Lorraine Woellert and John McNamee, with Laura Cohn and Alexandra Starr, in Washington

**ENRON
WATCH**

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THE ECONOMY

HALF-SPEED AHEAD!

Despite signs that the economy is picking up, a glut in manufacturing capacity will slow recovery

As recessions go, the downturn of '01 has been unprecedented. The housing market has stayed strong, and consumer spending has held up. Two other forces, however, have really done serious damage: a deep dive in production as manufacturers worked off bloated inventories, and the sharp collapse of capital investment. After a buying binge in the late 1990s, U.S. companies suddenly found themselves with too many goods and too much manufacturing capacity. Their response: savage reductions in capital spending and inventories. Together with the fall-out from the September 11 terrorist attacks, those factors drove the economy into its first recession in a decade.

Now, though, there are signs that some of the business bloodletting may be easing, especially on the inventory side. The fall in inventories has been nothing short of breathtaking, with manufacturers, wholesalers, and retailers getting rid of stocks at a record clip. Manufacturers alone have slashed stocks by \$30 billion over the past year. Indeed, they have been cut so extensively that many companies are now finding their cupboards nearly bare.

For the hard-pressed U.S. economy, that's mighty fine news. After a year

of cutting production, companies from auto giant General Motors Corp. to optical-fiber maker Corning Inc. are finally starting to rev it up to ensure they have enough inventories on hand to meet current and future demand.

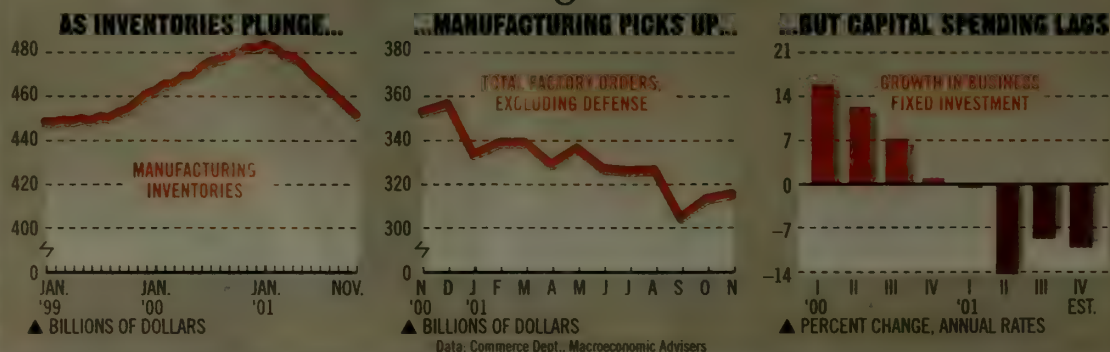
Just getting back into gear, though, won't bring about a full-fledged recovery. For that to happen, companies must start to boost capital spending once again. But with manufacturers operating at just 75% of capacity, the lowest level in 18 years, a strong upturn in capital spending remains a long ways off. Still, the need to rebuild inventories is a necessary first step on the road to recovery, and a sign that the economy may well have bottomed out. "Companies have done a lot of housecleaning," says Morgan Stanley economist Richard Berner. "The recession appears to be ending."

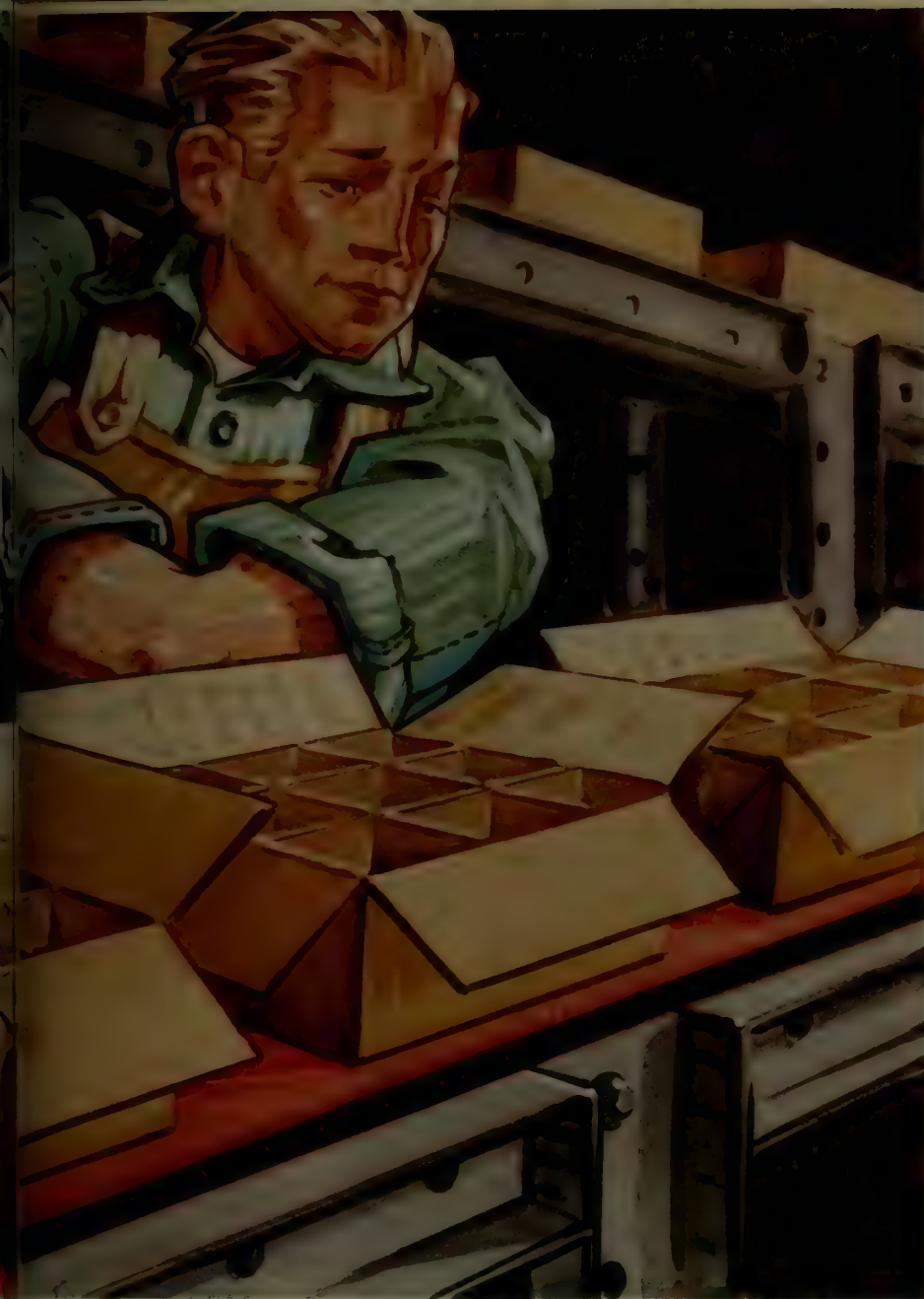
Nowhere is that more true than in manufacturing, the sector which has borne the brunt of the downturn. On Jan. 8, the Commerce Dept. reported that factory orders outside of the defense sector rose 0.8% in November after jumping 2.9% in October. The first back-to-back increase in nondefense orders in nearly a year, those numbers signaled that the beleaguered manufacturing sector may finally be on the mend. "Our order book has ticked up in the last month significantly," says United States Steel Corp. Chairman and CEO Thomas J. Usher. Even better: Some manufacturers, including steelmakers and chip and chemical companies, have seen enough of a revival in demand to raise prices.

Inventories have been

News like that has Federal Reserve Chairman Alan Greenspan and his colleagues growing more hopeful the economy may have weathered the worst, even if they're not yet ready to declare that a full-fledged recovery is underway. "The economy is at the bottom," New York Federal Reserve President William McDonough told reporters on Jan. 8 in Frankfurt. Such optimism may stem from the willingness of central bankers to cut interest rates again when they meet on Jan. 29-30. Even in the battered industrial sector, there are clear

How Strong A Bounce?





ever, are playing it safe. Daimler-Chrysler's Chrysler Group is holding production steady in the first quarter. Ford Motor Co. planned to slash output by 9% but is likely soon to revise first-quarter production plans upward. Shrinking market share made both companies cautious about their winter sales prospects, especially after the 0% financing deals pulled sales of one million autos, industrywide, into the fourth quarter of 2001 from the first quarter of '02. They worry, too, about the global glut of capacity that is hanging over the entire industry and acting as a deadweight on prices and profits. North America alone can produce three million vehicles more than are sold here in a good year.

Retailers are in much the same position as the auto makers. Like Detroit's Big Three, they pulled forward quite a bit of demand into the Christmas selling season through massive and widespread discounting. And they're stuck with too much capacity after a 1990s' store-building boom. That's got retailers and their suppliers vigilant on costs. "Whether it's inventory or personnel decisions or capital expenditures, it's a time to be conservative, not aggressive," says Frank D. Bracken, president of apparel maker Haggar Corp. "That's the way we're playing the game."

Indeed, even if the economy is bottoming out, few executives have forgotten that a surfeit of capacity remains through much of the economy. That excess capacity is likely to keep a lid on capital-spending plans for many months

ew that companies are finally having to increase production

the wholesale slashing of inventory is coming to an end and that production is starting to turn up. Take printing, the world's biggest maker of optical fiber, a market that has been devastated by the collapse of the telecommunications industry. The company announced on Jan. 4 that it was starting production at four plants after it succeeded in bringing inventories in line with sluggish sales. "It's not like we are going from zero to a hundred in an hour in one day," cautions Managing Chief Financial Officer James Flaws. "This will be a slow ramp-up. But it is a ramp-up nonetheless. Another sign of emerging need to reduce inventories: renewed pricing power in the semiconductor industry. Companies are raising chip prices as customers, particularly PC makers, are looking after a better-than-expected

Christmas season. South Korea's Samsung Electronics Co., the world's No. 1 memory chip maker, has raised prices three times since the start of December, by more than 50%.

Much of the recent progress on the inventory front has come from Detroit. The fall's 0% financing offers allowed the Big Three and their dealers to clear out huge amounts of swollen stock. At yearend, the Big Three's auto stocks totaled 2 million vehicles, a 26% drop from the end of 2000. "Our inventory levels are in a nice position," says General Motors Vice-Chairman and Chief Financial Officer John M. Devine. As a result, the company, which launched an across-the-board \$2,002 cash rebate on all its vehicles in early January, is stepping up production 7% in the first quarter, to 1.3 million vehicles.

Detroit's other two auto giants, how-

to come. In fact, a December survey by the Institute for Supply Management found that manufacturing companies expect to slash capital spending by nearly 15% this year. Says Daniel R. DiMicco, CEO of Nucor Corp., the nation's largest steelmaker. "Companies are going to have to start making money before they loosen their purse strings on capital spending."

Most recessions end with a bang as depressed consumer spending springs back and companies feverishly restock their shelves with inventory. But with businesses still reeling from the bust of '01, this recovery is more likely to start with a whimper.

By Rich Miller in Washington, with William C. Symonds in Boston, Robert Berner in Chicago, Wendy Zellner in Dallas, Jim Kerstetter in San Mateo, and bureau reports

COMMENTARY

By Steve Rosenbush

A LENGTHY HONEYMOON AT LUCENT?

It appeared to be the big job no one wanted. The search for a new chief of Lucent Technologies Inc. started way back in October, 2000. James McNerney Jr., a finalist in the race to head General Electric Co., was contacted. He opted to run 3M instead. Intel Corp. and Nortel Networks Corp. veteran David House politely declined. Nor could Alcatel honcho Krish Prabhu be persuaded. Finally, on Jan. 7, company veteran Patricia F. Russo, who only eight months earlier took the No. 2 spot at Eastman Kodak Co., agreed to step into the breach.

Little wonder volunteers weren't lining up for the job. A widespread industry collapse, compounded by management missteps, had transformed the once-hot Lucent into a corporate basket case. Lucent lost \$16 billion in 2001. And with the outlook remaining gloomy for the telecom-equipment market, the stock has lost 90% of its value since late 1999. As it hastily unloads assets, Lucent's goal for 2002 is merely to break even.

Still, as bleak as Lucent's situation now seems, Russo, a 19-year veteran of AT&T and Lucent, may have been dealt a better hand than most believe. Interim CEO Henry B. Schacht has already done most of the dirty work. Since returning to the helm in October, 2000, after the ouster of Richard A. McGinn, he has shed unprofitable assets, revamped the product line, cut staff by more than 50%—some 65,000 jobs—and refocused Lucent on its traditional customer base of telecom giants.

Even better for Russo, a 49-year-old native of Trenton, N.J., expectations for the company are at an all-time low. With the big telecom-equipment buyers still scaling back their spending plans, no one figures on seeing growth again anytime soon.



GOOD TIMING: Most of the dirty work has already been done for Pat Russo

The best most investors are counting on is that the bleeding has been stanchied. And most new CEOs get a bit of honeymoon, particularly at companies as beaten up as Lucent.

All of which means investors won't be looking for too much out of Russo's Lucent until late this year or early in 2003. And that's just about the time when many analysts expect the equipment market itself to finally start picking up again. If Russo can control costs and convince customers to buy more from the company's revised product line, she could emerge from Lucent's current quagmire looking smart. "The strategy and the

product plan are right," says Russo. "And I can accelerate them."

Of course, Russo must first deal with telecom's dark days, which are only going to get darker in 2002. In the boom years, capital expenditures rose at annual rates of 30% or higher. Last year's bust caused outlays to shrink 5% in the U.S. market. That's nothing compared with the 30% drop in capital expenditures at ABN Amro Inc. analyst Ken Leon expects in 2002, based on a poll of 30 carriers around the world. The problem: Demand for services has never materialized at the rate the telecom industry was banking on. Revenue from new data services should grow at only 15% this year, half the growth rate the industry had long promised.

Simply to break even this year, Russo will have to keep a lid on costs even as she jump-starts effort to get sales growing again. Otherwise she may be forced to cut even more jobs. And promoting the new optical, data-networking, and wireless systems Lucent unveiled last November will be heavy slogging. Competitors such as Cisco, Juniper, and Ciena have products arguably as good or better for comparable price. But Russo is well-positioned to make Lucent's case to top telecom executives, many of whom, like her, got their start at AT&T. Russo needs "to get into the shoes of her customers," says AT&T Wireless CEO John Zeglis.

She has done it before. In 1992, she fixed AT&T's money-losing office phone business. At Kodak, too, "she seemed to be making progress at a pretty tough job," says Lisa O. Rapuano, research director at Legg Mason Inc., which owns shares of Lucent and Kodak. With a combination of fortuitous timing and skillful management, she just might be able to do the same for Lucent.

With Geoff Smith in Boston

RUSSO'S TOUGHEST CHALLENGES:

A WEAK MARKET

Lucent's U.S. customers could cut capital spending 30% this year

MORE CUTS

Without profits, Russo may have to shave more jobs and assets

NEW PRODUCTS

Lucent's new optical and data-networking products must sell well

ECHOSTAR: WHY YOU DON'T MESS WITH THE MOUSE

1 Disney try to block Charlie Ergen's deal with DirecTV?

By any measure, Charlie Ergen is a business phenom. Just 15 years ago, having decided against importing skin wallets from South Korea, he was selling large-dish satellite systems door-to-door. Since then, stoked by loads of cash and a heavy dose of competitiveness, he and his EchoStar Communications Corp. have become a force in the media business by offering cut-rate satellite-TV service. After outmaneuvering Rupert Murdoch's News Corp. in October to buy satellite-TV heavyweight DirecTV in a \$30 billion deal, the Tennessee na-

COMBATIVE

has a knack of making things more difficult for himself," says one critic

It looked as if he was set to join the elite rank of media heavyweights. But now that competitiveness may be getting in the way of his own plans.

Ergen's deal to merge the top satellite companies into a TV distribution behemoth with more than 17 million subscribers already faced a difficult antitrust review by Washington. That only got uglier in late December, when Ergen decided to strip two Walt Disney Co. channels from EchoStar's programming. Ergen's opponents, it was a textbook example of how a monopolist might operate, and the move has helped opposition to the merger. "He has a knack of making things more difficult for himself," says Gene Kimmelman, co-director of the Consumers Union, an advocacy group.

A federal judge, who has so far presided over the Echostar move, will hear the case on Jan. 17. Ergen claims he needs the space now used by ESPN Classic and the Family Channel, both owned by Disney, to make room to carry local TV stations, as required by the Federal Communications Commission. Disney says that Ergen is simply trying to negotiate a lower rate for channels.

Industry observers are already betting on Disney to win. They say that

Ergen's gambit echoes the failed effort by Time Warner Inc. in 2000 to take ABC off eight of its cable systems. It had to back down in the face of scrutiny by federal regulators who were then contemplating its merger with America Online Inc.

Even worse, the Disney fight, as



CHARLIE HITS SOME STATIC

Now lining up against Ergen's proposed DirecTV merger:

NEWS CORP. The spurned DirecTV suitor has been lobbying Congress to kill the deal

DISNEY A spat over EchoStar carrying two Disney cable channels has the Mouse quietly fighting the deal

TV BROADCASTERS ABC and scores of local stations are opposing the merger after Ergen tried to get around rules that require satellite to carry local channels

well as criticism from a host of Ergen's past foes, are suddenly creating a lot more opposition to the merger than a month or two ago. News Corp., a one-time merger partner against whom Ergen filed a nasty lawsuit in 1997, is lobbying heavily to overturn the deal. Disney, which had said it would stay neutral, is already working behind the scenes against the merger. And Ergen is facing opposition from the politically potent National Association of Broadcasters. The NAB claims that Ergen misled it by agreeing to carry local TV stations in 1998, only to join a suit seeking to overturn rules requiring him to do so. "EchoStar has a history of challenging congressional mandates, ignoring FCC rules, and bad-faith business dealings," says Edward

O. Fritts, the president and chief executive of NAB.

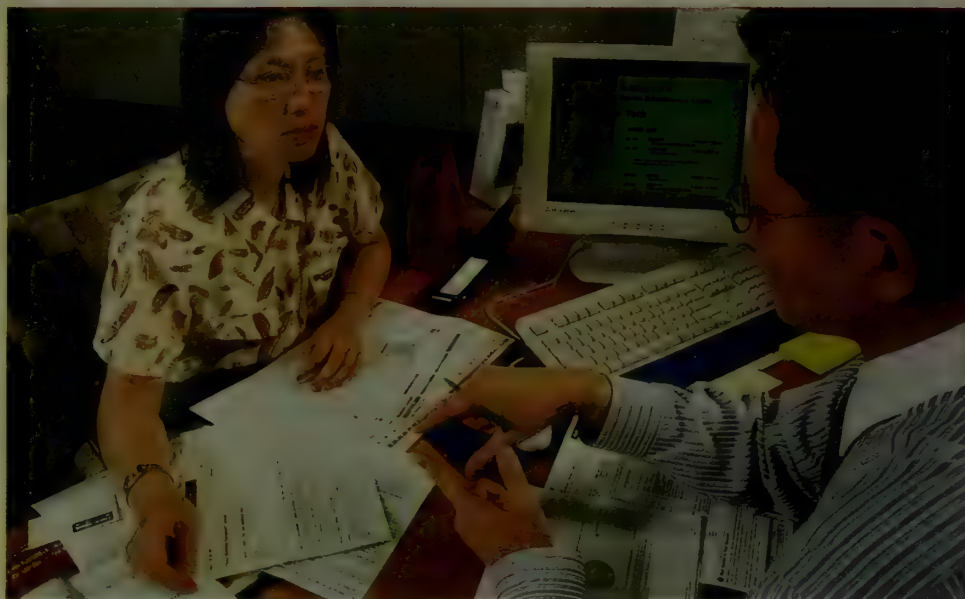
Ironically, until recently Ergen seemed to be making headway on his claim that the merger wouldn't create too much concentration. Even with 17 million subscribers, he would control only a fifth of the market for cable and satellite TV. So instead of thwarting competition, the merger with DirecTV would give him the size to better compete against giant cable operators such as AOL Time Warner. Even consumer advocates like Kimmelman—who worried that Ergen would raise rates for rural customers without alternatives—were on his side. Their bigger fear was that Murdoch would grab DirecTV and favor News Corp. programming.

The Disney brouhaha throws into question Ergen's claims that he would not act the part of a monopolist, hiking rates for rural users or kicking off channels that did not agree to his terms. Ergen says that he was responding to Disney's demands that he pay a rate increase of 15% for the ESPN chan-

nel to keep the media giant from lobbying against the merger in Washington. "This may go down as the stupidest thing in the history of mergers, but I have to look at myself in the mirror every morning, and I wasn't going to pay Disney hush money to go away," says Ergen. Disney denies asking for any rate hikes.

Whatever. Even if Ergen is right on the merits, he's losing the political and image war. This is one fight the Tennessee scrapper should have resisted.

By Ronald Grover in Los Angeles, with Amy Borrus in Washington



BROKERAGES

WILL INVESTORS PAY FOR SCHWAB'S ADVICE?

It's heading into territory in which rivals are well-entrenched

Independent financial adviser Thomas Gryzmala has kept all of his clients' stock-trading accounts at Charles Schwab & Co. since 1992, using it as a custodian for millions of dollars in assets. But lately, the Alexandria (Va.) adviser has parked clients' money at TD Waterhouse.

Why the change? Gryzmala is mad. Now that the online trading craze has faded, Schwab is increasingly selling investment advice from advisers on its own payroll. That treads on almost 6,000 independents such as Gryzmala who bring Schwab a third of its total client assets of \$833 billion. "I can't feed the competition," says Gryzmala, who won't keep new clients' money at Schwab.

The ire of independent advisers is just one of the hurdles that San Francisco-based Schwab faces in transforming itself from America's premier discount broker into a full-service house. After the markets turned south in 2000, retail trading slowed. In the third quarter of 2001, Schwab's average daily trades were down 26%, to 187,800, from the same period in 2000. That convinced Schwab that its slick Web site and discount trades wouldn't hack it

any longer. Its response: advising on trades, not just executing—an old idea in the business but a new one at Schwab. Brokers who once sent clients to independent brokers for advice now dispense it. High-end customers get the kid-glove treatment at U.S. Trust, the tony advisory firm Schwab acquired in 2000. "If [Schwab] doesn't offer advice, it risks losing the customer relationship altogether," says Matthew McGinnis, an analyst at Cerulli Associates Inc., a consultant to financial-services companies.

Advice can be lucrative. Schwab's Portfolio Consultation, an analysis of a client's holdings and a couple of hours' worth of advice, costs \$400. Schwab will also manage a client's money for a yearly fee based on assets. But competition is fierce. Most of Schwab's rivals are attempting to offset lost trading fees by selling advice. Adding to the pres-

A CLOSER RELATIONSHIP

Schwab plans to raise advisers' salaries by 15% to help close the pay gap with full-service rivals

sure is Schwab's poor financial performance. Bear Stearns & Co. analyst S. Butte estimates that 2001 net was \$391.4 million, down 50.6% from \$792 million a year earlier, on revenue of \$4.35 billion, a decrease of 24.7%. Schwab's stock has dropped 40% since the start of 2001. On Jan. 7, Butte downgraded Schwab's stock from "buy" to "attractive," citing low trading volumes. Schwab's earnings are due in mid-January.

Schwab declined to make executives available for interviews. But in a recent October conference call with analysts, co-CEO David S. Pottruck defended the strategy. "We're talking about a strategy that's objective and not driven by emotion," he said. "That's what separates Schwab apart from every competitor." Pottruck downplayed the conflict of interest between independent advisers: "All of them coexist very well."

But obstacles abound. Schwab has historically paid less than full-service brokerages and therefore is likely to have trouble luring top advisers. Former advisers say Schwab advisers earn \$100,000 tops—a fraction of what senior advisers at full-service firms earn. Former Schwab managers, who declined to be identified, say that means some Schwab advisers are twentysomethings with little personal investing experience. "Here they are advising people on retirement," says one. Another estimates that as of mid-2001, "only 20% of Schwab's adviser force [could] really deliver quality advice for the average client." A Schwab spokesperson counters that all advisers are qualified with varying experience: "You don't have to have 100% of the staff all operating at the exact same level." Schwab, which cut 23% of its workforce of 26,000 in 2001, plans to raise advisers' salaries 15%, analysts say.

At heart, Schwab has a marketing problem. For years it has sold itself as the place for do-it-yourself investors on a tear. Now it wants to be the financial adviser with the time in the week for your grandad's broker. That will be tough for Schwab to make that leap.

By Louise Lee in San Mateo, Calif.

A DAUNTING TRANSITION

GOAL

- Turn its brokers into investment advisers
- Boost sales through cold calls
- Become a full-service brokerage

CHALLENGE

- Company culture geared toward volume-discount trading
- Staffers used to taking orders, not drumming them up
- Fierce competition from the likes of Merrill Lynch and Morgan Stanley

By Catherine Yang

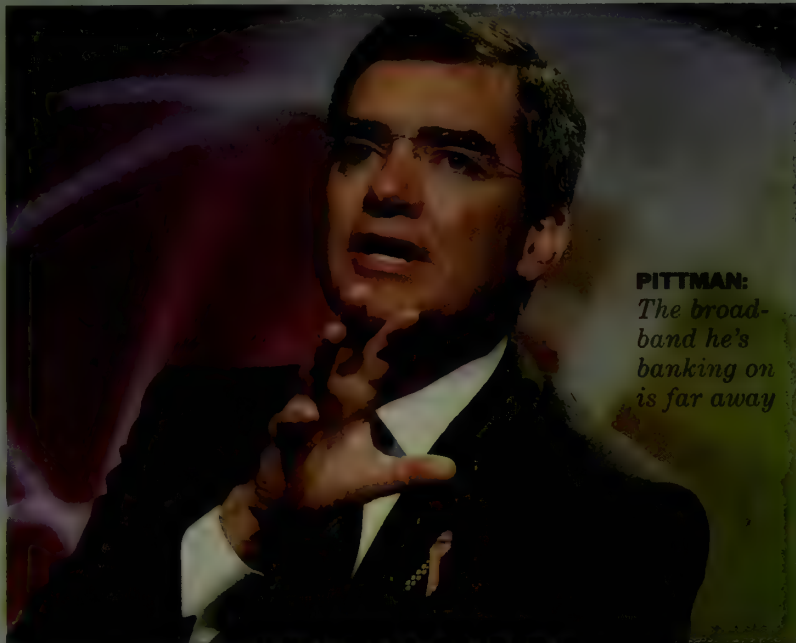
AOL'S SPUTTERING ONLINE GROWTH ENGINE

On Jan. 7, AOL Time Warner CEO-designate Richard D. Parsons broke the bad news: This year, his company will grow at about half the rate originally promised when its \$7 billion merger closed a year ago. Because of the ad recession, he said, revenues will rise only 5% to 8%, while cash flow will be just 8% to 12%. The announcement hardly helped the company's standing on Wall Street. Since the merger closed in January, 2001, AOL Time Warner Inc. stock has fallen 33%, to \$32 on Jan. 9 (page 85).

But the drop in ads for the magazine, TV, and online units is only part of the problem. A deeper worry is the plight of AOL itself. Generating a quarter of the company's revenues and cash flow, the AOL Online division is the company's engine for long-term growth. After all, the delivery of Time Warner's content to AOL's 33 million on-

line subscribers via fast Web links was the merger's founding vision. But now, the combination of slowing growth for dial-up subscriptions and the pokey progress of AOL's broadband business could cause that engine to sputter. "I don't see any near-term [growth] catalysts for the company," says Storm Boswick, portfolio manager of a technology fund at W. Seligman & Co., which has sold AOL shares.

After years of heady growth, some subscriber slowdown was inevitable. AOL membership grew by only 24%, to 33 million, last year, compared with a 30% jump in 2000. In the U.S., AOL says it will probably get some 3 million new subscribers in 2002, down from 3.7 million in 2001. And growth will likely continue to shrink as the number of U.S. dial-up users plateaus at about



PITTMAN:
The broadband he's banking on is far away

YOU'VE GOT PROBLEMS

SLOWING SUBSCRIPTIONS The saturated U.S. dial-up market means fewer new users and more discounts needed to get them.

FALLING AD SALES Anemic ad revenues may not revive until later this year. In their place, Time Warner is pushing its own magazines, music, and other content to boost revenues.

LAGGING FOREIGN BUSINESS AOL faces stiffer competition from foreign phone companies and Internet service providers. And buying back Bertelsmann's share of AOL Europe in 2002 could cause a \$300 million loss.

50 million households over the next five years, according to online researcher Jupiter Media Metrix Inc. That will mean a big dent in cash flow: Along with a soft online ad market, the subscriber stall will cut AOL's cash-flow growth from 76% in 2000 to as low as 18% in 2002, says Anthony Noto, an analyst at Goldman, Sachs & Co.

That's why AOL is counting on broadband. By mid-2002, it plans to launch premium-priced services, such as Web phone calls and HBO-on-demand delivered via a connected set-top box to consumers' TVs. COO Robert W. Pittman has said that someday, AOL could charge subscribers \$159 a month for broadband access, multiple users per household, telephony, online music, games and films. "The way we can make this a growth company is if we're constant-

ly inventing these services," he says.

But those plans may be tough to pull off. For starters, simply converting dial-up users to broadband won't dramatically boost cash flow. Sure, AOL charges as much as \$54.95 per month for broadband access, vs. the current \$23.90 for dial-up service. But AOL's sole cable partner, Time Warner Cable Inc., reaches only 20% of cable households. If it wants to provide broadband services to its customers through other cable companies, AOL will have to pay about \$30 a month per user, according to Lehman Brothers Inc. So, even if AOL persuades other cable operators to deliver its service, it will pay them a hefty cut.

It's also far from clear that consumers will bite. AOL's broadband service may already be pricey for many. While AOL has 4.6 million broadband users, only an estimated 10% get their links

through AOL. Most buy directly from their phone or cable providers and pay AOL just \$23.90. With entertainment budgets per U.S. household currently estimated at \$120 a month, AOL's plans "become a harder sell," says Jupiter analyst Joe Laszlo.

What's more, AOL will face stiffer competition in broadband from Microsoft Corp. Its MSN unit also plans to leverage the giant's software strength by offering services such as online banking, games, and music. Broadband "opens up the game again," says Bob Visse, director of MSN Marketing. Indeed, if AOL wants to claim its supposed broadband birthright, it had better get serious. Otherwise, it may get an even colder shoulder from Wall Street—and subscribers.

With Tom Lowry in New York and Jay Greene in Seattle

PHARMACEUTICALS

BRISTOL-MYERS SQUIBB IS FEELING WOOLY

The drugmaker faces challenges on several new products

When ImClone Systems Inc. dropped a bombshell on Dec. 28 about problems with the Food & Drug Administration application for its new cancer drug Erbitux, the fallout extended well beyond the biotech upstart. The news was a blow to Bristol-Myers Squibb Co., which agreed in September to co-develop and co-promote Erbitux. Bristol bought \$1 billion in ImClone stock and agreed to pay the company \$1 billion as the drug hit key milestones including final FDA approval.

That pricey investment speaks volumes about Bristol these days. The deal was part of Bristol Chief Executive Officer Peter R. Dolan's aggressive bid to remake the drug giant in the face of slowing growth. But with FDA

problems surfacing just months after Bristol inked its deal, analysts are raising questions about whether the company's need to bolster the pipeline took precedence over due diligence. "How desperate was Bristol to get product?" asks Mike Kren-savage, an analyst at Raymond James & Associates.

Dolan declined to be interviewed. But Richard J. Lane, president of Bristol's worldwide medicines group, says the company remains confident about the future of Erbitux. "There is no doubt it works," says Lane. And certainly, the ImClone setback

will not be devastating for Bristol. Analysts believe the drug will be approved eventually, and it was only expected to contribute about \$600 million to Bristol's sales by 2005—a modest figure for a company with 2001 revenues of nearly \$20 billion.

Still, Dolan's job just got a whole lot tougher. It's no surprise he's been scrambling to fill the pipeline. As the company loses exclusivity on some big products, includ-

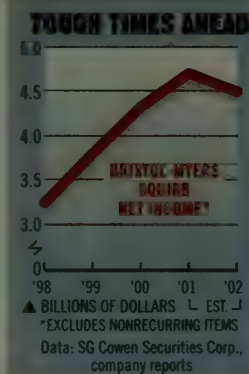
healthy average annual rate of 10% the past four years, SG Cowen Securities Corp. analyst Stephen M. Scala is intensifying generic competition and cost of the ImClone and DuPont will send Bristol's net income down this year, to \$4.5 billion on sales of billion. And while Scala says 2002 mark a return of healthy growth, Bristol as new products launch, aren't so sure. Bristol's stock is about 30% over the past year, to a \$50. Warns Samuel D. Isaly, managing partner of OrbiMed Advisors, a pharmaceutical fund-management firm: "Br-

problems are too widespread to be covered over by near-term pipeline."

The ImClone head doesn't help. ImClone said the FDA's question late largely to data collection. But ImClone executives acknowledged on Jan. 9 the agency could require other clinical trial, a that could postpone drug's approval until That delay could hurt

competing therapies from companies AstraZeneca PLC could also be on market by then.

Bristol has even more at stake Vanlev, its hypertension drug. Expected to be a multibillion-dollar blockbuster, Vanlev was held up after the FDA asked for more data on a potentially dangerous side effect. And while approval is expected this year, Lehman Brothers analyst C. Anthony Butler says could be limited if the drug has a



DOLAN Given the hurdles ahead, it's no wonder the CEO has been trying aggressively to delay generic competition

ing the \$2 billion-in-sales diabetes drug Glucophage, cheap generic competitors will grab market share from Bristol. In response, Dolan has shed slower-growing businesses such as hair-care operation Clairol and focused on pharmaceuticals. In addition to the ImClone deal, he shelled out \$7.8 billion for DuPont's drug business in October.

But questions remain about whether Dolan has done enough. After seeing earnings grow at a

er incidence of side effects than peting therapies.

Given the challenges ahead, it's no wonder Bristol has been fighting aggressively to delay generic competition. It has been sued, for example, by a number of states and consumer groups over what they contend were improper tactics to delay the launch of a generic competitor to Bristol's anti-anxiety drug BuSpar. But such delaying tactics likely won't solve Bristol's fundamental problem. That's why some on Wall Street believe that Dolan may strike more licensing or acquisition deals. Bristol Lane says the company hasn't made more deals out. Even given the ImClone setback, Dolan may need to roll the dice a few more times.

By Amy Barrett in Philadelphia

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Managing Business on the InternetSM

EDITED BY MONICA ROMAN

THE HIGH COST OF MERRILL'S CUTS

WHEN MERRILL LYNCH CHAIRMAN and CEO David Komansky picked Stanley O'Neal as his president and heir apparent in July, everyone expected O'Neal to lay off thousands and take an ax to the bloated costs weighing down America's No. 1 broker. They just didn't expect it would cost so much: On Jan. 9, Merrill announced that 9,000 job reductions and other restructuring moves resulted in a \$2.2 billion pretax charge in the fourth quarter. Merrill assured investors and analysts that the most painful cuts were over and that the firm was now the right size to take advantage of growth opportunities in a modest economic recovery in 2002. But some analysts remain skeptical that O'Neal will be able to reinvigorate Merrill's business, especially if the economy does not pick up as the firm expects. Merrill could

also lose more top talent after employees receive bonuses the week of Jan. 14.

RED INK FLOWS AT ALCOA

IF THERE WERE ANY DOUBTS about how bleak this January's earnings would be, Alcoa has laid them to rest. Traditionally the first industrial giant to report quarterly results, Alcoa said on Jan. 8 it lost \$142 million in 2001's final period—its first quarterly loss since 1994. The world's top aluminum producer blamed the red ink on a 21% fall in sales, to \$5.18 billion, and a \$241 million charge to cover plant closings and 6,500 layoffs. The good news: Analysts expect the Pittsburgh company to earn \$214 million in the first quarter, as a rebounding economy lifts aluminum demand and prices.

HOMESTORE.COM: WOLFF HEADS HOME

HOMESTORE.COM ANNOUNCED the resignation of founder and CEO Stuart Wolff in the wake of an accounting investigation that could result in a substantial restatement of revenues. Wolff was replaced as head of the leading provider of online home listings by Michael Long, former chairman of online health site WebMD. Trading in Homestore shares, which had been halted for two weeks, resumed at around 2, a fraction of its former high. Thirteen lawsuits alleging profiteering by Wolff and other insiders have been filed. Among the biggest losers was Cendant, which sold its online real estate business to Homestore two years ago in exchange for \$641 million in stock. A Cendant spokesman said that the company may write down the value of its Homestore stake in the fourth quarter, possibly to zero.

HEADLINER: SUSAN LYNE

ADJUSTING THE PICTURE AT ABC

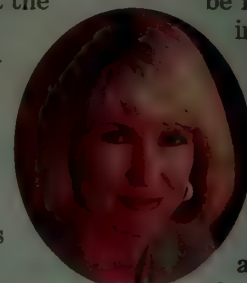
Susan Lyne, who landed the top programming job at the ABC network on Jan. 7, got her start at the Walt Disney unit overseeing made-for-TV movies like *The Three Stooges*, *Annie*, and *The Beach Boys*. Now, as president of ABC's Entertainment Television Group, she'll face her own drama. The 51-year-old Lyne will be charged with turning around a network that this season has lost 21% of its audience and ranks fourth among the 18- to 49-year-olds that advertisers covet.

A former reporter for *The Village Voice*, Lyne founded *Premiere* magazine

after working for Jane Fonda's production company in Hollywood. At ABC, she'll be responsible for fixing new hits to offset the decline of onetime ratings champ *Who Wants to be a Millionaire* and faded mainstays *Dharma & Greg* and *The Drew Carey Show*. She replaces Stu Bloomberg, who suffered from recent flops such as *Bob Patterson* and *Thieves*.

For her part, Lyne is taking the long view. "There is no magic bullet," she says. "This is a process that will take quarters, not weeks, to turn around."

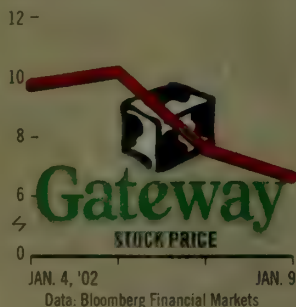
Ronald Gro



CLOSING BELL

GATEWAY CRASH

Investors punished Gateway after it warned that its fourth-quarter sales would be 17% below analysts' expectations. The news sent the computer maker's shares plunging 25%, to \$7.69, on Jan. 8. And when Gateway's debt was downgraded to junk status, the shares fell a further 12.7%, to \$6.71, the next day.



IN DESKTOP PCs, IBM CLICKS ON 'QUIT'

IBM, THE COMPANY THAT PUT the personal computer on the map, announced on Jan. 8 that it would no longer manufacture desktop PCs in most of the world. The decision marks the latest step in IBM's retreat from the PC business. Under a three-year, \$5 billion agreement, IBM's PCs will now be made by contract manufacturer Sanmina-SCI. As part of the deal, Sanmina will acquire IBM's desktop facilities in the U.S. and Europe, including 980 employees. Unable to compete against low-cost leader Dell Computer, IBM's PC group has lost money and market share for years.

MORE VCS HANG UP THEIR CLEATS

THE SITUATION FOR VENTURE capitalists just keeps getting

worse. The latest evidence came on Jan. 8, when Bardsdale Group, a Silicon Valley venture firm founded in 1977 by former Netscape Communications execs, announced it was closing. Jim Barksdale, the former Netscape CEO, blamed the difficult economic environment. "Last spring became obvious to us that we didn't want to raise a fund," Barksdale said. He's alone. Other venture firms are also concluding that only the best and brightest will survive the downturn. Venture investors say requests for funding have all but dried

ET CETERA...

- Dave Thomas, founder and senior chairman of Wendy's International, died at 69.
- Motorola will lay off nearly 20% of its 600 top executives.
- AT&T said it plans to issue tracking stock for its long-distance business.

EDITED BY RICHARD S. DUNHAM

BUSH VS. DASCHLE: WHO'S BLOWING SMOKE ON THE TAX CUT?

Cluster bombs are falling, and the heavy artillery is taking aim at weak points in enemy defenses. No, not in Afghanistan—in the escalating political fight over taxes and economic policy. In a nasty runup to the November election, President George W. Bush and Senate Majority Leader Tom Daschle (D-S.D.)—still allies in the War on Terror—started trading rhetorical salvos over blame for the recession and resurgent deficits. Unfortunately, both deserve more credit for energy than accuracy.

Daschle started the squabble on Jan. 4 by blaming the Bush tax cut for slashing budget surpluses—and worse. “Not only did the tax cut fail to prevent a recession,” he argued, “it probably made the recession worse.”

The next day, Bush counterattacked. “Not over my dead body will they raise your taxes,” he told a crowd in Ontario, Calif. In his daily radio address, he implied Democrats have cost 943,000 people their jobs by failing to pass a stimulus plan.

The argument that a backdated tax cut decimated the 2001 surplus is absurd—especially coming from Daschle, who backed big rebates last year. His long view is arguably more credible, however. Short-term rates, controlled by the Fed, have plunged from 6.4% to 1.8% since December, 2000. But rates on 10-year Treasuries have barely fallen from 5.24% a year ago to 4.5% on Jan. 9. Daschle, backed by former Treasury Secretary Robert E. Rubin, says that over the next 10 years, Uncle Sam will have to borrow more than \$1 trillion to pay for last year's tax cut. The bond market, worried that Washington has lost fiscal discipline, has pushed long-term rates higher than they might otherwise be, Daschle says. That, in effect, taxes everybody who borrows.

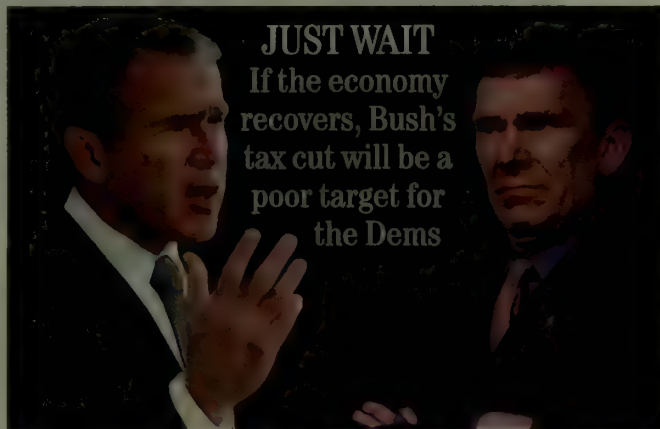
But there are other reasons why long rates are high. Rates may not have dropped because foreign investors are buying fewer U.S. bonds or because of bullishness about the recovery. And rates are still quite low by the standards of the past 25 years, says financial economist Donald Straszheim. Just ask the millions of Americans who refinanced their homes.

Daschle is certainly on stronger ground when he says the tax cut has eaten away the surplus. The projected 10-year surplus of \$5.6 trillion is expected to shrink by \$3.7 trillion over the next decade. Of that, nearly half (\$1.7 trillion) will be caused by Bush's tax cut, according to congressional estimates.

Meanwhile, Bush's suggestion that Daschle is itching to roll back the tax cut is simply not true. Also, it's a stretch to blame Daschle for every layoff in Dubuque. To believe Bush's claim that Senate inaction cost 943,000 jobs is to believe that modest stimulus would have prevented pink slips. Bush's Council of Economic Advisers said in December that failure to enact a stimulus package would cost 300,000 jobs—and many economists consider that number too high.

The debate puts Daschle in an awkward position. A dozen Senate Dems, including three in tough reelection battles, voted for the tax cut and now chafe at Daschle's criticisms. Besides, the public prefers Bush's economic agenda by 50% to 36% over that of Hill Democrats, says Democratic pollster Mark Penn. Overwhelmed by Bush's post-September 11 popularity, Democrats are scrambling for traction. If the recession lingers, it will bolster their arguments. But if conventional wisdom holds and the economy rebounds, this early skirmish shows how tough it will be for Dems to bad-mouth Bushonomics.

By Howard Gleckman



CAPITAL WRAPUP

JAB AT JEB

Florida Governor Jeb Bush is about to get caught in the crossfire over taxes. The reason: By using big brother George's definition of tax increases, Jeb has advocated at least 10 tax hikes. Or so Democratic partisans would have you believe.

Here's the logic: President Bush argued on Jan. 4 that congressional Democrats would be endorsing higher taxes if they tried to postpone any of the 10-year, \$1.35 trillion cut enacted last year. By delaying the promised

tax relief, Democrats are actually increasing the tax burden on working Americans, the White House argues.

Democrats dismiss the President's charges as political sophistry but eagerly note that if they are tax-raisers, so is George's little bro. That's because Jeb wants to slow down the phase-in of the estate-tax repeal mandated last year by the tax cut signed into law by the President. He also proposed a two-year delay in tax cuts on stocks and bonds. Jeb's argument for postponing the tax repeals eerily similar to Democratic argu-

ments in Washington—is that the state can't afford to lose more than \$300 million in revenues in the midst of a recession.

And Dems, who have made Jeb's reelection defeat a top priority for 2002, are preparing to quote George as they go on the attack. “Does the President think his brother is raising taxes in Florida?” asks Democratic pollster Mark Mellman. Not likely, but the Bush family may be learning that political hyperbole can come back to bite you.

By Richard S. Dunham

ARGENTINA

A WRONG TURN?

Argentina's financial crisis may get much worse

It was painful to watch even for those with no money at risk. On Jan. 6, Argentina finally let go of its decade-long embrace of the U.S. dollar and devalued the peso, ending one of the world's boldest experiments in economic reengineering. Overnight, the country went from being the world's 16th-largest economy to No. 23, and even before the peso was floated several days later, money-changers were paying up to 1.55 pesos for greenbacks. "We are bankrupt," admitted Economy Minister Jorge Remes Lenicov when he announced that the peg was dead. The new government also confirmed that Argentina can't go on servicing its \$141 billion public debt.

Devaluation and default: Economists have been predicting both for months. But some of the emergency measures that President Eduardo Duhalde and Remes Lenicov are implementing have stunned Argentines and foreign investors alike. A dramatic and alarming reversal in economic policy is under way that could plunge the country's economy into an even deeper crisis and erode political support for free-market reforms throughout Latin America. "We hope the biggest casualty of Argentina will not be the march of democratic capitalism in Latin America over the past 20 years," says Peter Geraghty, managing director at Darby Overseas Investments, Ltd. in Washington.

But some of what the Duhalde team is doing looks all too much like a throwback to the failed strategies of the 1970s and '80s. The government is reinserting itself into Argentina's economic life via the introduction of a dual exchange rate, capital controls, extraordi-



BAD NEWS FOR FOREIGN INVESTORS

BANKS Spanish- and U.S.-owned banks will take a big hit as the government converts dollar loans of \$100,000 or less into pesos at a rate of 1 to 1, though the official rate is now 1.4.

UTILITIES Privatized telephone, power, and water companies, mostly in the hands of European investors, will suffer as the government converts dollar-denominated revenues into pesos.

OIL PRODUCERS A proposed tax on oil exports of at least 20% may scuttle plans by Spain's Repsol to invest billions to develop Argentine oil reserves.

CREDITORS Holders of Argentina's \$132 billion foreign debt, much of it in bonds held by U.S. and European institutional investors, may recoup only pennies on the dollar.

Data: BusinessWeek

nary taxes on oil exports, and unilateral changes to the contracts of private utilities. These measures, along with halt in debt payments, risk turning Argentina into a pariah in global investment circles. "After a decade of thin emerging markets, investors are waking up to the fact that it was the big hole," says Christian Stracke, chief Latin America strategist for Commerzbank Securities.

Both Wall Street and Argentine business leaders are skeptical that Duhalde can even pull off a controlled devaluation. Brazil attempted it in 1999 to see its currency plunge. Already, the International Monetary Fund warned that Duhalde's plan for a tier exchange rate—with an official

4 pesos per dollar for exports and a floating rate for most other transactions—won't work. If history is any guide, the two rates will diverge widely and demand for dollars soars, forcing the government to dig deep into its dwindling stock of foreign reserves to ensure the scheme's survival. Indeed, in a devaluation report, J.P. Morgan predicted that the free-floating peso will be worth a mere 37¢ by yearend.

Duhalde is also courting controversy over his treatment of the nation's banks, most of which are foreign-owned. The administration plans to convert around one-third of the \$50 billion in dollar-denominated loans held by the banks into peso loans at the old 1-to-1 exchange rate. Consumer and small-business loans of up to \$100,000 will be eligible. But critics point out that with Argentines paying off loans in devalued pesos, the scheme will blow a big hole in the balance sheets of local subsidiaries of Citibank, BankBoston and several big Spanish banks. The J.P. Morgan report warned that, already, Argentina's "bank sector is effectively bankrupt."

Other targets of convenience for Duhalde & Co. are the foreign owners of the telephone, water, and electric utilities that were privatized in the 1990s. Authorities say the companies must bill their clients in pesos, not dollars—a dictate that will slam revenues. The list of casualties includes Spain's Telefónica, which operates the largest phone company; power provider Endesa; and water utility Aguas de Barcelona. They, **ALDE ON TV:** along with other government Spanish investors, will be a bigger economic player of \$40 billion into Argentina.

Meanwhile, Spanish oil company Repsol, which paid \$15 billion in 1999 for former Argentine oil monopoly YPF, is racing for a proposed 20% tax on oil exports that could eat up more than \$100 million in revenues over five years. They are sticking their hand in the pockets of many who came to the country to invest in good faith when nobody wanted to," says Argentine lawyer Jorge Pérez Alati, whose firm represents several foreign investors, including recently formed Argentina Bondholders' Committee. Duhalde spokesman Ricardo Amadeo insists the govern-

COMMENTARY

By Pete Engardio

ARGENTINA WAS IN TOO BIG A HURRY

Was Argentina done in by bad advice from the International Monetary Fund or by its own profligate politicians? Did it open its markets too fast or too slowly? Was the strategy of anchoring the peso to the U.S. dollar flawed from the outset? Or would it have worked had Buenos Aires finished all its reforms? Economic pundits are vying to put their own spin on the demise of yet another bold 1990s experiment in market liberalization.

This blame game is pointless. As with other spectacular blowups—Thailand, Indonesia, Russia—one can't count all the culprits. In Argentina, the policies of the early 1990s, and all the mistakes that followed, were the work of elected politicians. The IMF indulged Argentina with money and public endorsements even after the country lost all financial discipline. The thousands of creditors who pumped \$141 billion into the country should have known the risks—and must now pay the price.

The lesson from the collapse of Argentina and many other IMF clients is that radical attempts to turn closed, ill-managed emerging markets into sturdy free-market economies in a few years rarely work. Economists can argue until they turn blue that Argentina's currency board, or Russia's shock therapy, or Indonesia's IMF reform package, would have worked had these countries only done this or that. But such strategies require near-flawless execution. In reality, developing-nation leaders face too many political and economic constraints to pull everything off overnight. And investors who stampede in based on promises of reform tend to fuel unsustainable booms.

Take Argentina. Desperate to halt hyperinflation, President Carlos Men-



em adopted a policy to back all pesos in circulation with dollars held in reserves. That halted inflation but the only way left to fund deficit spending was to lure new dollars via exports, investment, or debt. Just printing money was out. Menem privatized state-owned companies to raise funds. Investment flooded in, the economy surged.

But borrowing zoomed when investment slowed and recession threatened in 1995. To win reelection, Menem let the provinces run big deficits and shelved reforms to make it easier for companies to shed workers. Then, in 1999, Brazil devalued its currency, laying bare how overpriced Argentina had become. Yet Buenos Aires clung to the peg. Imports poured in, investment halted, and Argentina went bust. "Menem didn't seize the opportunity to finish reform. And the capital markets took their cues from the IMF and U.S. Treasury, which stood behind Argentina," says Columbia University economist Charles W. Calomiris.

Argentina should have ditched the dollar peg when it became clear it couldn't maintain the discipline needed to make it tenable. The economy, investors, and the IMF's reputation would have taken hits. But Argentina might have recovered so long as it continued reform, as Mexico, Russia, and South Korea have done. The process might have taken many years. But Argentina probably wouldn't be facing catastrophe now. This meltdown should mark the end of an era when developing nations, and investors, bet the bank on complex, big-bang liberalization schemes.

Engardio reports on global business and economics from New York.

ment isn't singling out foreigners. "We don't want to expel these companies or hurt them," he says, "but this is the reality we face."

Because the crisis had been percolating for more than a year, the biggest emerging-market debt default in history has resulted in little financial contagion so far. The same week Argentina devalued, Brazil and Mexico together sold \$2.75 billion in government bonds—proof that the appetite for even Latin American debt has not evaporated.

Still, one casualty of Argentina's meltdown might be the Bush Administration's plan to push for a Free Trade

Area of the Americas by 2005. "With Argentina's collapse, Latin America looks like a less attractive trade partner to many in the U.S.," says Peter Hakim, president of Washington think tank Inter-American Dialogue. The debacle also will inspire debate over how best to prevent financial brushfires from becoming conflagrations (page 43).

There's an outside chance that Duhalde can yet repair some of the damage. One encouraging sign would be a balanced budget for 2002, proof that Argentina intends to live within its means. "We have lost substantial credibility," concedes Martin Redrado,

an economist who is the Foreign Ministry's secretary for global economic affairs. "We need to show that the country is serious." Given its shaky economy, it may be months, even years, before Argentina achieves that goal.

By Geri Smith, with Joshua Man in Buenos Aires, Cristina Blad in New York, and Andy Rol in Madrid

BusinessWeek online

For more on Argentina's crisis, go to the Jan. 21 issue at www.businessweek.com

BRITAIN

BLAIR'S STEALTH EURO STRATEGY

Can he win over reluctant Britons to the currency?

Even as Europeans celebrate the successful Jan. 1 launch of euro coins and notes, one question dogging politicians and bankers across the Continent is: "When will Tony Blair join the party?" Britain is sitting on the fence, and European policymakers are eager to draw it in. They worry that the new currency won't be a true rival to the dollar until Britain—the European Union's second-largest economy—embraces it.

As Britain's Prime Minister, Blair would certainly like to lead his country into the euro zone. He fears that Britain will be taken less seriously in European councils as well as Washington if it remains on the fringes. He also fears that the pound's volatility against the euro may scare off foreign investment. "The euro is now a reality," he said on Jan. 3. "So I think the idea that we can run away from it and pretend it doesn't exist would be very silly."

He may well be right. But Blair faces an uphill task persuading the British public to accept the euro. Public opinion is running against it by 2 to 1. Despite his proven electoral prowess, Blair would probably lose a referendum on the euro if it were held today.

So Blair's strategy is to try to change minds while preserving the option of backing away. He will be watched closely by such Cabinet colleagues as Chancellor of the Exchequer Gordon Brown and Foreign Secretary Jack Straw. These politicians won't want to see their own



future prime ministerial chances squandered in a losing cause. "Blair can't stick his neck out until he sees a substantial move in the polls," says Robert M. Worcester, chairman of the MORI polling organization in London. Worcester, Britain's best-known pollster, doubts Blair will see that shift before the next general election, which must occur by May, 2006.

But some analysts think a persistent campaign could turn the tide. An early January survey by YouGov, a London online polling agency, found that 18% wanted Britain to adopt the euro as soon as possible, while 34% were in favor of joining "if and when economic conditions are right." That means 52% were broadly supportive, while just 46% were in the two "no" categories: "stay

OPPOSITION

With voters solidly anti-euro for now, Blair won't stick his neck out too far

out on principle" and "stay for at least the next four years." Says Stephen Shakespeare, director of opinion search for YouGov: "I would not think the government they can poll on this in a year or two." Blair plans to use corporate allies such as British Airline Pilots' Association Chairman Colin Marshall to warn the public that Britain will lose influence and suffer economically if it chooses isolation. Should public opinion shift, Blair will raise his profile.

But the respective economic fortunes of Britain and the euro zone aren't helping make the case. The Bank of England has proved much more resilient than the European Central Bank at warding off the effects of the global slowdown. Michael P. Siders, a Schroder Salomon Smith Barney economist in London, forecasts 2.2% growth for Britain this year, vs. a paltry 1% for the euro zone.

Indeed, Blair will be reluctant to join if the performance of the euro and its managers does not improve. That means an end to squabbling at the ECB. A recovery in the euro's value against

the dollar and sterling also seems a requisite. "We are trying to sell a currency that the tabloids are trying to persuade the British people is a failure," says Simon Buckby, director of Britain in Europe, the pro-euro lobby organization. "It needs to be a success."

It is hard to imagine why Blair, Europe's most successful politician, would want to put his reputation on the line for such a hotly contested issue. Having destroyed his opposition in elections, he may think he can put just about anything.

By Stanley Reed in London

Imagine a world
where health problems are prevented
before they even start.

*Why do the Japanese have 1/8
the incidence of prostate cancer and
fewer symptoms of menopause?*

Is it a diet rich in soy?



ADM is finding out and creating
natural supplements called nutraceuticals.

*So everyone—everywhere—benefits
from foods that promote good health.*



THE NATURE OF WHAT'S TO COME



EVERY HOURS
11:30AM-10:30PM
11:30AM-11:00PM
12:00PM-11:00PM
12:00PM-11:00PM



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COMMENTARY

By Carol Matlack

EARTH TO AIRBUS: WHAT'S THE FLIGHT PLAN?

Airbus Industrie Chief Executive Noël Forgeard can expect plenty of tough questions when the European aircraft maker holds its annual briefing for journalists and analysts on Jan. 17 in Paris. Just last summer, Airbus was reaping a record harvest of orders at the Paris air show and preparing for a big boost in production. Now it's being pummeled by the worst downturn in its 30-year history. Airbus' usually upbeat commercial director, John Leahy, said recently that aircraft orders this year could fall 60% below the 2001 level. That means revenues will

where most of its 44,000 employees work. Eliminating jobs at its French, German, and Spanish factories would be politically difficult and costly because of tough anti-layoff laws. Compare that with U.S. rival Boeing Co., which axed 30,000 jobs and took a \$700 million fourth-quarter write-off.

True, Airbus doesn't need to slam on the brakes as sharply as Boeing did. Boeing's commercial jet business has shrunk, from a peak of 620 deliveries in 1999 to an estimated 375 this year. Airbus, by contrast, has hiked production

Smith Barney. And while Airbus has won tentative approval for its first military contract, the A400M transport plane, that project won't generate revenues for several years.

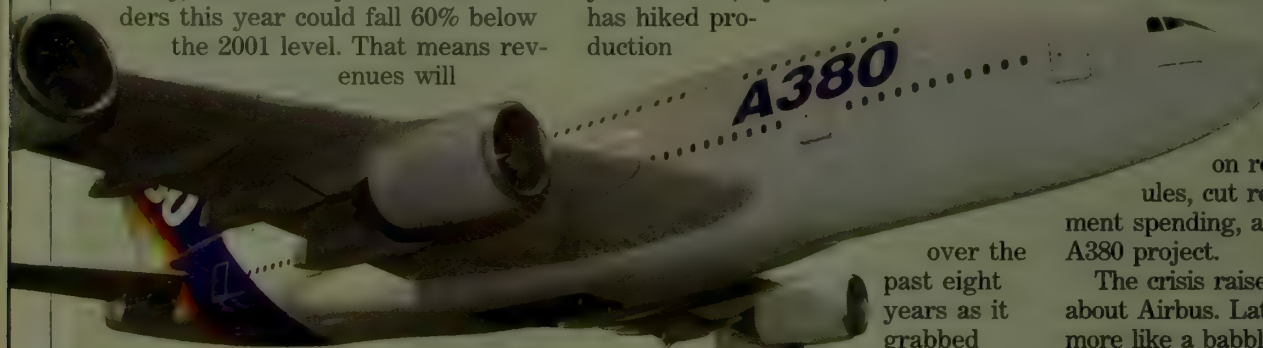
What should Forgeard do? Certainly, he must resist the urge to lure back customers with the deep discounts that Airbus has used to build market share in the past. Cutting costs is essential. Although laying off workers will take time, Airbus should start the process now, because 2003

and 2004 are shaping up to be even worse than this year. In the meantime, the company could put some employees on reduced work schedules, cut research and development spending, and slow down the A380 project.

The crisis raises deeper questions about Airbus. Lately, it has sounded more like a babble of voices than a corporation. Even as Airbus stuck to rosy projections last year, some managers and EADS executives quietly warned analysts that forecasts would be cut. Public statements were baffling: Shortly after Forgeard said no layoffs were needed, Airbus announced

2,000 job cuts in Britain, then reduced the number to 500. Such confusion is no great surprise, given that Airbus was formed less than two years ago from a loose consortium of French, German, and Spanish companies. But it's bad news for EADS, which—since the planemaker is publicly traded—is treated by investors as a proxy for Airbus. EADS, itself the product of a delicate cross-border merger, may hesitate to push Airbus into a politically difficult downsizing. If the numbers don't improve soon, though, it may have to do just that.

Matlack covers European business from Paris.



remain anemic through 2003 and 2004, since orders are usually booked well over a year before the expected delivery date, and at least 80% of the purchase price is paid on delivery.

It's high time Airbus spelled out a plan to steer through this turbulence. It already has slashed projected deliveries to 300 in each of the next two years—30% below earlier estimates—as financially strapped customers delay or cancel scores of orders. But most analysts think those forecasts are still too optimistic and say deliveries could fall into the low 200s by next year. The slowdown couldn't come at a worse time. Over the next four years, Airbus is committed to spend at least \$10.7 billion on developing the A380, a double-decker superjumbo scheduled for launch in 2006. Operating profits, which reached \$1.3 billion in 2001 on sales of \$17 billion, will be cut in half this year and could disappear by 2003 unless costs are cut.

So far, Airbus' response has been oddly muted. After September 11, the company froze a planned expansion of capacity, and it recently announced 500 job cuts in Britain. But no layoffs are planned in continental Europe,

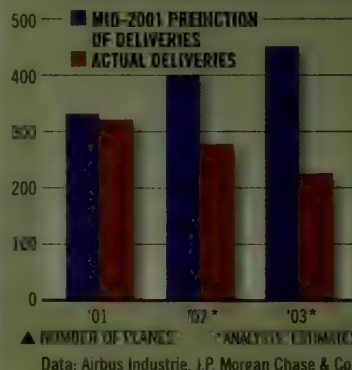
where most of its 44,000 employees work. Eliminating jobs at its French, German, and Spanish factories would be politically difficult and costly because of tough anti-layoff laws. Compare that with U.S. rival Boeing Co., which axed 30,000 jobs and took a \$700 million fourth-quarter write-off.

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Forgeard has said that Airbus can remain profitable even if deliveries slide below 300, although some employees might be placed on reduced work schedules if the number drops to 270. As for mass layoffs à la Boeing? In an interview with the newspaper *Le Monde* in November, Forgeard said: "That's the American management style...to appear to take radical steps to reassure investors." Trouble is, investors do need reassuring. Shares in European Aeronautics Defense & Space Co. (EADS), which owns 80% of Airbus, have slumped 40% in the past year. Boeing stock is down 30% but has rebounded more strongly than EADS since September 11. It's hard to see how Airbus can remain profitable on its present course. "Their cost base is clearly sized for a lot more than 300 deliveries," says analyst Nick Cunningham of Schroder Salomon

over the past eight years as it grabbed market share.

AIRBUS' REALITY CHECK



EDITED BY ROSE BRADY

SHOULD EUROPE SPEND BIG TO MODERNIZE ITS MILITARY?

It was an historic moment. On Sept. 12, a day after terrorist attacks in the U.S., NATO solemnly invoked a key article in its charter for the first time. From France to Turkey, member countries declared that the attack on the U.S. was an attack on all of them—a decision never taken even in the darkest days of the Cold War.

But the U.S. didn't ask its European partners to join en masse in a retaliatory attack on al Qaeda and the Taliban in Afghanistan. That's largely because Europe lacks firepower—stealth bombers to precision guided missiles and, crucially, the systems to integrate them. So apart from a few British cruise missiles, reconnaissance flights, and special forces, the U.S. had to wage its own war and leave Europe on the sidelines. Europeans "haven't invested enough to plug in to the new world of warfare," says Klaus Becher, senior fellow at the International Institute for Strategic Studies in London.

Now, as the U.S. ponders moving on to a new terrorist target, debate is brewing in Europe as to just what its new role should be. The Afghan war starkly highlighted Europe's deficiencies, spurring German Chancellor Gerhard Schröder and British Prime Minister Tony Blair to push for increased European defense spending. Currently, the EU pumps about 2% of its gross domestic product, or some \$205 billion, into the military, vs. the U.S.'s \$343 billion, or some 3% of GDP. While no one expects the EU to close the gap, more powerful leaders are arguing that Europe must boost its capabilities—or be relegated indefinitely to a second-tier role in global military operations. That could mean being sidelined in decisions that affect European interests as well.

The outcome of this defense debate is far from certain. A variety of groups, from labor unions to the Greens, oppose higher military spending. And the European Monetary Union

imposes strict limits on budget deficits, thus precluding a major surge in spending. But proponents of a stronger European military say it's necessary so the Continent can take care of problems in its own backyard, such as the Balkans. And, they argue, a more confident Europe could check what they perceive as American unilateralism. Many Europeans fear the U.S. won't consider their views before deciding whether to target Iraq as a terrorist nation. "There's no [European] leverage," says Henning Riecke, senior fellow at the German Council on Foreign Relations in Berlin. Others worry that European troops will end up only with peacekeeping duties—as in Afghanistan. "We have to do the dangerous, muddy-boots stuff," complains Julian Lindley-French, a British analyst at the European Union's Institute for Security Studies in Paris.



GERMANY: Schröder wants more outlays

In the end, it may take years for the Europeans to figure out their new defense role. But the issue is likely to gain attention in this year's elections. The French defense Establishment was humiliated when France's sole aircraft carrier couldn't leave port at the start of the Afghan war because it was undergoing repairs. Now, presidential candidate Jean-Pierre Chevènement is making France's military unpreparedness a big campaign theme for this spring's ballot. Meanwhile, Schröder, up for reelection this fall, had to scale

back German peacekeeping efforts in Afghanistan because of a lack of transport planes. Now, he is seeking parliamentary approval to buy 73 Airbus military transports—at a cost of \$6 billion.

Schröder is likely to get his planes. But these are just initial forays in what is likely to be a major battle over the Continent's resources—and its place in the world.

By John Rossant in Paris and Christine Tierney in Frankfurt

GLOBAL WRAPUP

WARNING TO JAKARTA?

In the wake of the arrests of 28 alleged Islamic terrorists by Singaporean and Malaysian police late last year, pressure is growing on Indonesia to crack down on militants. Malaysian police suspect two Indonesians of plotting with other extremists to attack U.S. targets in Singapore. Authorities are also worried about militant groups that have staged violent protests at the U.S. Embassy in Jakarta. Indonesian Muslim leaders condemned the arrests, revealed in early

January. Some Western diplomats see the announcement of the arrests as a warning to Jakarta and a trial balloon for gauging local Muslim reaction. U.S. officials recently suggested militants in Southeast Asia could soon be a target of the anti-terror campaign.

ITALY'S EURO-SKEPTICS

► The ouster on Jan. 5 of Italian Foreign Minister Renato Ruggiero could lead to unexpected economic fallout. Prime Minister Silvio Berlusconi asked the highly regarded Ruggiero to resign after he criticized the government's

weak commitment to the new European currency. That tilted the balance of power in Rome toward euro-skeptics such as Minister for Institutional Reform Umberto Bossi and Deputy Prime Minister Gianfranco Fini.

While they are not strong enough to derail Italy's overall commitment to Europe, they are working behind the scenes to help Italy delay European Union-driven reforms such as liberalization and privatization. If they succeed, Italy's already-lagging competitiveness could slip further behind the rest of the EU.

STRATEGIES

3M: A LAB FOR GROWTH?

CEO Jim McNerney—the first outsider boss—is overhauling a company long known for innovation

Throughout its 100-year history, 3M has had a surefire formula for growth: hire top-notch scientists in every field, give each an ample endowment, then stand back and let them do their thing. That anything-goes approach has yielded thousands of new products over the decades, from sandpaper and magnetic audio tape to Post-it Notes and Thinsulate insulation. Indeed, 3M generated \$5.6 billion in sales in 2000—fully one-third of its revenues—from goods that didn't exist just four years earlier.

But that's not good enough for 3M's new boss. Sure, that record of innovation impresses Chairman and Chief Executive W. James McNerney Jr., the first outsider to take the helm. Yet he

argues that even with a \$1 billion budget and a staff of 7,000, 3M's vaunted products laboratory won't be able to achieve the growth he wants. And how much is that? McNerney audaciously predicts he can double the record numbers of 2000 in 10 years or less. Previously, it took the St. Paul (Minn.) conglomerate 15 years to do that.

In that regard, McNerney, 52, is off to a slow start. Sales and profits have fallen since he arrived from General Electric Co. on Jan. 1, 2001, with revenues dropping faster than at any time in the past 30 years. 3M's health-care unit has been growing rapidly, but telecom sales are off sharply. Building on some adept cost-cutting and improved efficiencies, 3M weathered 2001 well enough that industry analysts and

institutional shareholders are bullish on McNerney's long-term plans. But achieving them will be far from easy.

To hit his targets of increasing earnings by 11% a year and operating earnings by 12%—nearly twice the rate of the past decade—the newcomer concludes that he needs to pull off a string of large-size acquisitions and plunge into new services. As all sorts of companies have discovered recently, though, taken-

don't always pay off. Moreover, 3M has little experience in making big purchases. "One bad acquisition, and targets are out," says analyst John E. Everts of Merrill Lynch & Co. On top of 3M's catalog of sticky ticket products not lend itself easily to add-on services may be able to

BACK IN FAVOR ON WALL STREET



McNERNEY PUTS HIS STAMP ON 3M

The company's new chairman has launched several initiatives since arriving a year ago.

SOURCING 3M is planning to move more manufacturing to lower-wage sites overseas and to pool its purchases across divisions to get lower prices.

SIX SIGMA Taking a page from GE's playbook, 3M has specially trained "black belts" rooting out inefficiencies in departments from R&D to sales.

OVERHEAD COSTS 3M had been letting utilities, travel, and other costs rise faster than sales; they now total \$3 billion a year. It has hard goals for cutting these outlays.

PRODUCT DEVELOPMENT This has always been a 3M strength, but it is now pushing to get goods into the marketplace much faster by focusing R&D spending on the most likely prospects.

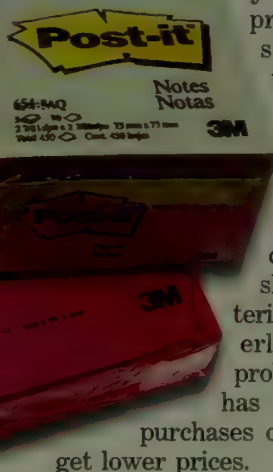
THE HUNT: To hit sales and profit goals, McNerney is making some sizable deals

ce contracts to maintain expensive goods, such as jet engines, but do Scotch tape buyers want 3M to ship their boxes? McNerney's new course also runs the risk of stifling 3M's hallmark creativity. And his lieutenants are already speculating where research and development dollars are spent and establishing uniform performance standards across 3M. It runs counter to its tradition of giving individual business chiefs free rein. "The most important thing about this single most important thing—you get to do things your own way," says Ronald O. Baukol, executive vice president for international operations, a 33-year veteran. 3M old-timers rally back McNerney, conceding money wasn't always wisely spent. McNerney says he understands the balance act: "My job is to add scale in a

fast-moving, entrepreneurial environment. If I end up killing that entrepreneurial spirit. I will have failed."

Indeed, he'll need all the creative energy 3M can muster if he hopes to rev up growth once the recession ends. Many on Wall Street believe that 3M can add a percentage point to its growth rate simply by creating and launching products more efficiently, a process McNerney says should bear fruit with new rollouts this year. (He won't be more specific). He also wants to pump up international sales.

But Wall Street is mostly rooting for McNerney because 3M has held up relatively well during the recession. Credit some GE-like cost-cutting measures. Only weeks after succeeding L. D. DeSimone, McNerney announced the layoff of 5,000 of 3M's 75,000 employees. He also instituted the money-saving Six Sigma process-management system company-wide. One small example: 3M had lost \$1 million a year because its ceramics, used in dental works, sometimes cracked. A review showed that the material hadn't been properly cured, and the problem was fixed. 3M has also begun pooling purchases on a global basis to get lower prices.



The balance sheet shows his handiwork. 3M had piled up almost \$440 million in cash as of Sept. 30, up 45% from the start of the year. Overhead expenses, meantime, were down 7% in the third quarter on a year-to-year basis. Altogether, the company's annual operating costs are \$400 million below the level they were at when McNerney arrived. Add in savings from layoffs and shifts of manufacturing and R&D to lower-cost sites abroad, and McNerney thinks he can save \$1 billion in 2002.

Investors appreciate the numbers. Even though 3M's stock price is down 2% since Jan. 1, 2001, that compares with a 9% decline in the Standard & Poor's 500-stock index. And since Sept. 21, 3M is up 34%, vs. 21% for the S&P 500. Matthew G. Baker, an equity analyst with MFS Investment Management

in Boston, used to think 3M had let costs get too high and its brilliant researchers grow lazy. "The potential of the company was a lot better than what was showing up in its numbers," he says. He upgraded his opinion last March and has doubled his 3M stake to 6.4 million shares.

Unquestionably, however, McNerney's ambitions have been slowed by the economic downturn. Analyst J. Jeffrey Ciani of UBS Warburg estimates that 3M's 2001 profits fell 13%, to \$1.61 billion from \$1.86 billion in 2000, excluding one-time items such as a \$600 million pretax restructuring charge, while revenue fell 4%, to \$16.1 billion from \$16.7 billion. The major culprit? 3M's battered telecom division, whose sales fell 10% in 2001 and may drop again this year. Even so, analysts say 3M's earnings should rise in 2002; Ciani, for instance, sees profits reaching \$2 billion.

The clear darling of the new chief is 3M's health-care unit, which pumps out everything from medical equipment and tooth-colored dental fillings to pharmaceuticals. One of the hottest products is the antiviral salve Aldara, a genital-wart treatment that could also prove promising against herpes. Health-care sales were expected to total \$3.4 billion in 2001, up 8% from 2000. "It is the highest-potential single thing we are doing," McNerney says. "If I could be twice as big in health care, I'd love it."

But don't expect him to sign blockbuster deals any time soon. McNerney says he has not even started a shopping list. He does, however, have some ideas about how to enter the service sector. 3M's telecom unit, for one, could cut deals to maintain the fiber-optic components it sells to phone companies. Whatever he adds to the mix, McNerney has vowed no massive reorganization at 3M. That, he says, could be demoralizing. "It's not a matter of machine-gunning the team because I'm new and I think I'm smarter and better," McNerney says. "This is taking a very good company and making it better."

3M's headquarters has a wall of fame featuring photos of its most innovative scientists, such as Richard G. Drew, who invented cellophane tape. Give McNerney time, and he could be there, too—as the man who turned a 100-year-old company back into a growth stock.

By Michael Arndt in St. Paul, Minn.

BusinessWeek online

For a Q&A with CEO James McNerney and more, go to the Jan. 21 issue online at www.businessweek.com

COMMENTARY

By Gerry Khermouch

BOOZE ADS: THERE GO THE CREATIVE JUICES

From the uproar following NBC's decision to air Smirnoff vodka ads last month, you'd think that liquor giant Diageo PLC and its peers had scored an overwhelming coup that can only help rev up the industry's single-digit growth rate. But while the awareness-building potential of TV ads is huge, spirits marketers who are toasting their good fortune should also consider what they may be losing. A rush to TV may well spell the end of a brilliant run of creative—and effective—marketing.

Until now, the major TV networks, while happy to air hundreds of millions of dollars' worth of beer ads each year, have refused to air ads for presumably more dangerous hard liquor, a distinction many spirits marketers challenge. But following distillers' intensive lobbying, both in Washington and with the networks, Diageo was able to buy the NBC airtime, promising four months of "drink responsibly" messages before moving on to product ads.

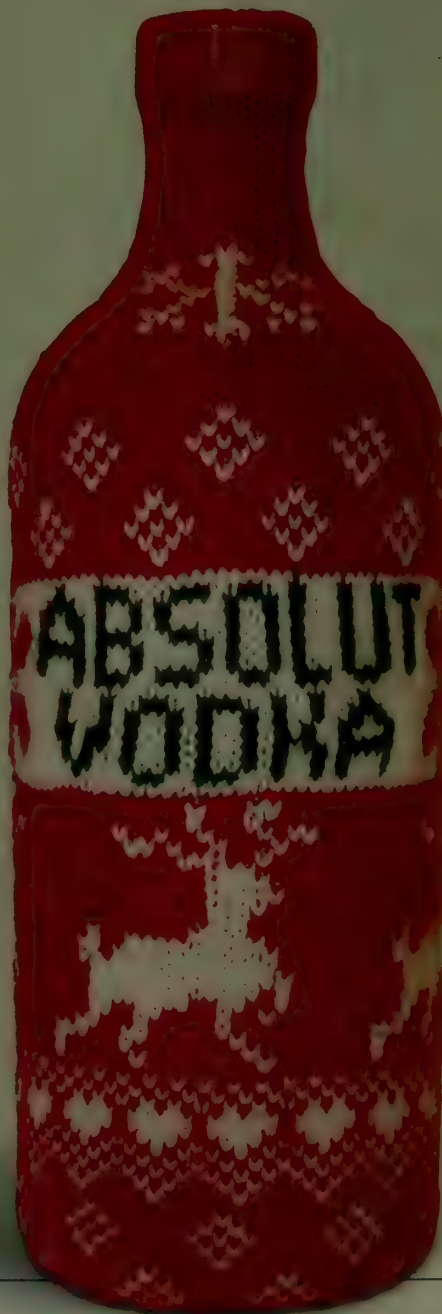
Assuming the other networks follow NBC's lead, some analysts are predicting a sweeping shift of media dollars into TV. Some forecast that spirits ads on TV, until now relegated to cable and local TV channels, could jump from last year's \$5 million to \$200 million or more in just two or three years. "If I were still at Seagram, I'd be celebrating," says marketing consultant Arthur Shapiro, who breached the cable-TV barrier in 1996 with ads for Crown Royal whisky. Until then, the industry had refrained from seeking TV buys.

Still, the breakthrough may entail a huge trade-off. That's because the prohibitions on broadcast ads forced distillers to become wildly inventive. Think of the Absolut bottle as superhero in ubiquitous print ads, sometimes carrying real holiday bottle sweaters or Father's Day ties. Or "Jägerettes," attractive young women who encourage bar patrons to order Jägermeister shots. Or Hennessy's undercover schmoozers, hired to

confide the cognac's wonders to their fellow barflies.

One has to wonder whether, given a chance to stampede into TV, distillers will lose the impetus to craft such painstaking, offbeat programs. That would be ironic, now that marketers in other categories are grow-

SPIRITED Without TV, companies had to be wildly inventive



PRIME PRINT CAMPAIGN: The bottle as superhero

ing disenchanted with TV and experimenting with the very techniques pioneered by booze marketers. Example: carmakers' recent efforts to tie in to cutting-edge films or foment buzz among influential consumers.

True, the sheer expense of network television will put it out of reach for many liquor brands. TV's CPM—the cost of reaching 1,000 homes—runs to \$15. Now consider an initiative by Diageo's UDV unit to create an island "nation" for Jose Cuervo tequila. It leased a tiny Caribbean island and garnered millions' worth of free TV coverage with stunts like petition drives to enter the U.N. or participate in the Olympics. With virtually no paid ad, the CPM worked out to a paltry 15¢, says Steve Goldstein, a former UDV exec who cooked up the scheme. "You can't even get that rate on community radio," he gloats.

Is it inevitable that TV ads will squeeze out such grassroots efforts? Booze marketers insist they'll take a considered approach. "We'll probably use TV, but it's not likely to be the next be-all and end-all," says Matt Wiant, senior vice-president for marketing at Allied Domecq PLC. "TV is a very intrusive medium. People greet TV ads with a healthy amount of skepticism because they know they're being advertised to."

But others think such a squeeze out is inevitable, particularly now that the once-insular spirits sector has been invaded by packaged-goo veterans, for whom TV ads are the default choice. "People will be taking the easy way, the way they were taught in commodity businesses at Procter & Gamble, Kraft Foods, and Colgate-Palmolive," warns Crillon Importers Ltd. Chairman and CEO Michel Roux, the man who earlier devised the Absolut campaign. "That's their mentality. And with the expense of TV, you can't do both." That happens, though, they will be easing off on the very things that put megabrands like Absolut, Cuervo, and Hennessy on the map.

Khermouch covers marketing for New York.

CUSTOMIZED IC SOLUTIONS

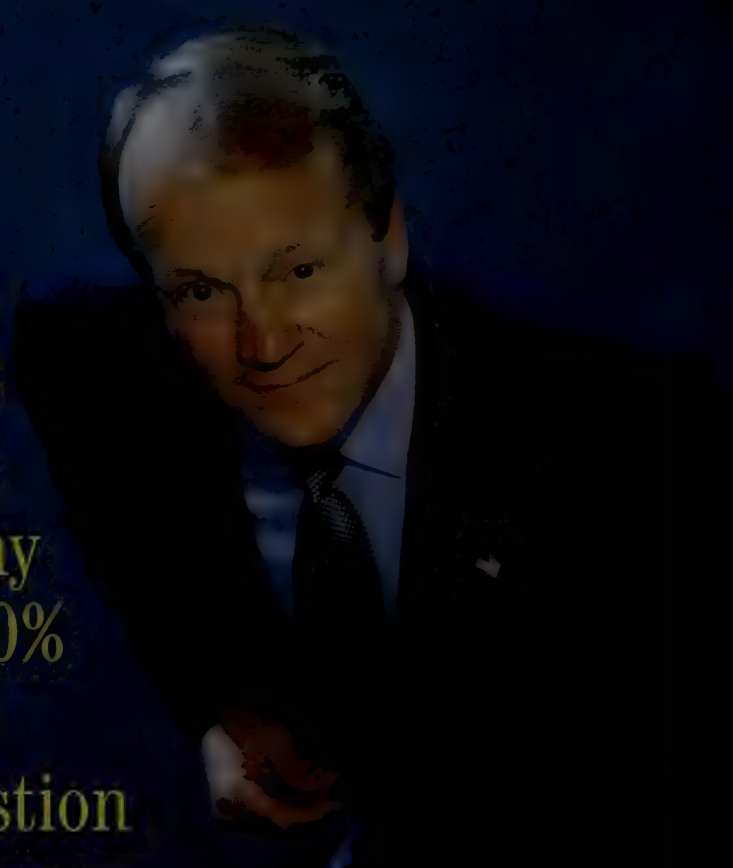
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**CEO JOHN
CHAMBERS**

still thinks
his company
can grow 30%
a year. But
critics question
its aggressive
accounting

CISCO BEHIND THE HYPE

The questions are brutal and surprisingly frank. Each one is a challenge Cisco Systems CEO John T. Chambers would not have heard even a year ago. "What can I do to combat the increase in politics and empire-building inside Cisco?" wonders a female employee. "Will we see more layoffs?" inquires another. "Does the Internet now have negative connotations?" asks one man.

Such candid employee question-and-answer sessions have been a staple of Chambers' management approach since he became CEO of Cisco seven years ago. But on this cool November morning in San Jose, Calif., in an auditorium filled with more than 200 staffers, the inquiries betray a sagging morale and unease that until recently were unknown inside this high-tech stalwart.

Once one of the world's fastest-growing companies, Cisco is struggling to find its footing amid a severe economic downdraft. The company is in the red. Its sales are slumping, and its market valuation has fallen by some \$430 billion, to \$154 billion, since March, 2000, one of the deepest losses of shareholder wealth in history. The decline puts many of Cisco's employee stock options under water and limits the company's ability to acquire new companies.

Yet even after this comeuppance, Chambers, 52, continues to insist in public and private that Cisco can still "change the world" and increase revenues as much as 30%-plus a year. Just as the spending boom of 1999 and early 2000 may have been overdone, he says, the dramatic shrinking of technology budgets in 2001 was also exaggerated—and temporary. He points to new markets, from voice-over-Internet systems and wireless networking gear to storage-networking devices and optical equipment, that he believes can fuel Cisco's next round of hypergrowth. "There is a confidence that if we execute right, we have a higher probability of winning now than ever before," says Chambers. "I believe the best years are in front of us."

But skeptics abound, starting inside the company auditorium where Chambers is getting the hard questions. Many are wondering if the ultimate Internet salesman of the 1990s is simply in denial. After all, the Cisco that dazzled investors and business observers at the height of the high-tech bubble now looks like a company that caught a spectacular wave. Its success and Chambers' own rise as a New Economy visionary were a function of a near mania for tech stocks. In those heady days, all the stars seemed to align in Chambers' favor: a massive Internet buildout, a breath-taking stock price, and an era that allowed companies to push the boundaries of acceptable accounting. "Cisco was at the right place at the right time and exploited it very well," says Robertson Stephens senior technology analyst Paul Johnson. "Chances are they won't be able to do it again."

There has always been a good deal of myth-making where Cisco is concerned. At the height of the Internet frenzy, it was the very embodiment of the age. When it came to Cisco, everything seemed faster, bigger, and better. Its sales and earnings growth were second to none. It sold more sophisticated gear over the Internet than any other company as it raced to fill a demand that seemed unquenchable. It could close its books in a day, thanks to its powerful information systems. For 43 quarters in a row, Cisco met or beat Wall Street's hungry expectations for higher earnings. For one brief, heady moment, it became the most valuable corporation on the planet.

Now, in the cold light of the tech downturn, some of those myths are being exploded. As academics and other experts reassess the tech era, they are raising serious questions about how well Cisco and other highfliers actually performed, even at the height of the boom. They say that a history of aggressive accounting, from massive write-downs of assets to the use of now-banned "pooling of interest" accounting for acquisitions, makes it hard to gauge how

Cover Story

RICHARD MORGENSTEIN

much many of these companies actually earned from ongoing operations. These bold accounting techniques became standard operating procedure at many companies during the boom. But few applied them as deftly or with greater effect than the much-emulated Cisco.

To be sure, Chambers' company is hardly an Enron in the making. Cisco's accounting practices, while aggressive, are not illegal and have been certified without qualification by PricewaterhouseCoopers LLP, its independent auditor. With \$19.1 billion in cash and equivalents, more than double that of competitors Alcatel, Lucent Technologies, and Nortel Networks combined, the company boasts a pristine balance sheet with zero debt. Plus, Cisco still holds a dominant share of the \$15 billion market for corporate network gear and has recently boosted its market share in some key product categories, including routers. Long term, analysts believe the company can achieve 15% to 20% annual earnings growth.

But Cisco's core business of supplying Internet infrastructure, while solid, is nowhere near capable of generating the 70% growth rates of yesteryear. After all, the corporations and telecom carriers that lined up for Cisco's gear in the '90s are spending much less to expand networks. Many of the telecom players are laden with debt and overcapacity. Some analysts believe the current down cycle for overall corporate capital spending could last years, even when the recession ends. Meanwhile, those that do want to spend can pick up some bargains. For example, eBay Inc. lists more than 3,000 Cisco products that are being auctioned for much less than their initial prices. "The bubble companies that fueled Cisco's growth have largely been wiped off the face of the earth," says Scott C. Cleland, chief executive of the Precursor Group, a high-tech consultant that recently bought \$27,000 worth of Cisco gear for \$7,000 on eBay. "Chambers' core business has matured, and all the growth markets are speculative." Indeed, in many of the

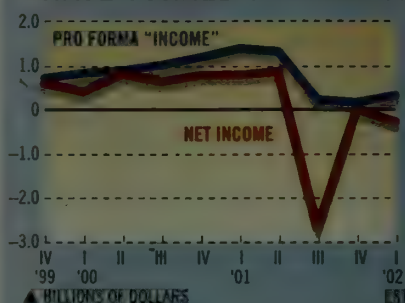
markets that Chambers points to as engines of future growth, Cisco faces large and entrenched competitors.

In others, such as voice-over-Internet, it's becoming clear that the potential first envisioned will take much longer to materialize.

Yet while the bubble has burst elsewhere in techdom, Cisco continues to exist in its own separate universe. Legions of true believers still cling to the hope that Cisco will reemerge as the high-tech bellwether that will lead the sector out of its slump. Their continuing faith is why Cisco stock trades at a spectacular 95 times estimated 2002 earnings despite losing money in 2001. A new study by Robertson Stephens estimates that even if Cisco grew at 20% annually over the next 10 years, to \$100 billion in sales, and sustained operating margins of 15%, an investor who bought the entire company at its current market value would earn a measly 3% return a year, based on projected cash flow. They'd be lucky to do so well. The chances of hitting that 20% growth target now seem a stretch.

For all the disquieting signs, an almost dreamlike view seems to prevail among the company's Wall Street supporters. In a 90-minute conference call between Wall Street analysts and Chambers on Nov. 5 to discuss first-quarter results, few analysts acknowledged that Cisco had posted a net loss of \$263 million or that sales had plummeted 32%, to \$4.4 billion. Nor did any of the analysts grill Chambers on the \$290 million Cisco disclosed that it earned by selling "excess inventory" written off as worthless only seven months earlier. (At the time, critics wondered if the huge sum included some still-good equipment that could

CISCO'S REAL PROFITS HAVE TURNED TO LOSSES...



...AND INVESTORS HAVE HAD A ROLLER-COASTER RIDE



Data: Bloomberg Financial Markets

be sold later, inflating the bottom line. "We have no plan to use it, period," a company spokesman told *BusinessWeek* in spring.) Without the gain, Cisco's net losses would have been nearly half a billion dollars.

It's not just the numbers that deserve greater scrutiny. Part of the Cisco myth revolved around the company's sophisticated information systems. Cisco was supposed to be using the Internet to bind together its suppliers and customers into a seamless whole, pointing the way to the corporation of the future. In fact, Cisco's "network organization" did little to soften the impact of the downturn. It saved Cisco from the disastrous inventory buildup.

Similarly, its vaunted acquisition strategy was supposed to make the world Cisco's lab, allowing it to pluck promising technology after someone else had borne the development risk. But many of the companies Cisco snapped up with inflated stock came with steep price tags, reaching as high as \$24 million per employee. Often, high-priced talent was



"We will likely find that even during its so-called heyday, Cisco wasn't nearly as profitable as many believe."

—MICHAEL PORTER
Harvard Business School

CARTER: The Cl...

Cover Story

THE CISCO HYPE



Chambers are accurate

soon after the deals were done. Many of those companies have yet to deliver new products or markets or contribute to Cisco's bottom line (page 60).

Indeed, there are serious questions about how successful many of the high-tech companies were during their halcyon days. Michael Porter, a Harvard Business School professor, is now completing a major research project on the era's massive distortions in financial reporting. One astounding finding: He and his colleagues can't figure out how much money Cisco really made in the 1990s. After spending billions on buying companies, Cisco routinely wrote off massive amounts of acquisition-related charges—\$5.4 billion in the past five years alone—making it nearly impossible to piece together how much Cisco actually in-

ed or how much it earned on its capital. Says Porter: "When the historians actually plow through all the data, they will likely find that even during its so-called heyday, Cisco wasn't nearly as profitable in terms of return on invested capital as many believed."

Chambers and his top executives strongly defend the company's accounting practices. "I've got an extremely conservative chief financial officer, and we have been conservative all the way through," says Chambers. "We provide a tremendous amount of information. The more information we provide, the more questions it raises."

Double is, even the most sophisticated forensic accountants had difficulty burrowing through the company's less-transparent financial reports. Only recently, for example, the Maryland-based Center for Financial Research & Analysis reported that a 3% growth in revenues from the previous quarter occurred only because Cisco reserved less for bad debts. The center used Cisco's own numbers released in its Nov. 5 conference call. Now, the center is backing away from the report because Cisco says it has actually been putting aside more money for uncollectible receivables, not less. However, not all of its offsetting "revenue adjustments" are spelled out in its filings. Concedes Chambers: "We've got to be able to articulate [our numbers] better."

Chambers may be chastened, but he hasn't lost his confidence or charisma. In his upbeat, rat-a-tat style, Chambers goes through a standard stump speech. He says the company's customer focus, culture of empowerment, prowess in acquisitions, and dominant market share will allow it to overcome the odds. "Let's not kid ourselves," he says. "This success is coming to us. It is going to consolidate. Who in this industry is better at consolidation than Cisco? And who, by the way, has the assets that Cisco does?"

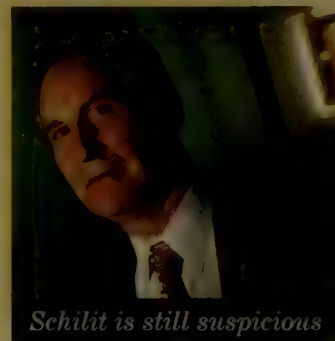
Even with questions about the company's past, no one doubts that Chambers can reestablish Cisco as a viable and highly profitable company. But Cisco's current market valuation is largely based on Chambers' highly optimistic view of the company's growth potential and Wall Street's willingness to accept its more bullish unaudited, pro forma financials. Chambers thinks he can reach his lofty growth targets by tak-

ing greater share from rivals and conquering new markets. But the chances of finding another bonanza like network switching, which helped propel Cisco's fast-track growth in the '90s, are slim.

Cisco insiders acknowledge the difficulty of returning to the growth rates of its glory days. "When you're a really tiny company, you can jump into one new market and it can make you a lot bigger," says Michelangelo Volpi, Cisco senior vice-president in charge of Internet switches and services. "You can't do that at Cisco anymore. You can't take a \$20 billion company and say one market is going to make us a \$40 billion company. In each of those markets, there will be entrenched competitors. They'll know the business well,

HOW CISCO TRIPPED UP THE SHERLOCK HOLMES OF ACCOUNTING

Howard Schilit, a former American University accounting professor, has been dubbed "the Sherlock Holmes of accounting." As the director of the Maryland-based Center for Financial Research & Analysis, he and his team of forensic accountants attempt to unravel financial results for major investors. But Cisco's latest quarterly results confused even him. If the most prominent forensic accountant couldn't get it right, what chance do investors have?



Schilit is still suspicious

NOV. 5, 2001 In a conference call with analysts, Cisco reveals that its "normal reserves for accounts receivable and credit memos, as well as reserves for leases and structured loans" had declined in the quarter to 9% from 15% despite a worsening economy.

NOV. 7 Schilit's Center releases an explosive report. It claims that Cisco's reduction in reserves was responsible for its reported 3.5% rise in quarter-to-quarter revenue. If Cisco had reserved at the previous quarter's level, it would have reported a revenue decline of 3.3%.

DEC. 12 Cisco files its 10Q. The percentage breakdowns for these reserves are nowhere to be found. But on page 20, Cisco refers to "revenue adjustments" that include such things as "customer incentives and other discounts." The \$409 million reduction in sales and \$649 million for the previous quarter match the reserve percentages reported on Nov. 5.

DEC. 21 Cisco vigorously disputes the Center's analysis after a *BusinessWeek* inquiry. The company insists that the "revenue adjustment" in its 10Q was one of many and does not reflect its total adjustments. Cisco points to data to support its claim that bad debt reserves have in fact increased, but it declines to detail all the adjustments.

JAN. 9, 2002 The center backs down from its analysis, but Schilit remains suspicious. "The fact that a company apparently said certain things in a conference call that don't jibe with its SEC filings obviously doesn't make one feel very comfortable," he says.

and they'll be tough."

It's a far cry from the '90s, when the company averaged 70% annual sales growth. But that torrid pace covered up a multitude of weaknesses. Cisco was famed for systems that were supposed to give its managers unparalleled access to real-time data. But when business weakened, those systems proved to be flawed.

Just how flawed became apparent shortly before midnight on Saturday, Jan. 27, last year, as the company prepared to close out its 2001 second-quarter numbers. Analysts were expecting a profit of 19¢ per share, but a slowdown in orders and shortages of certain parts would bring this quarter down to the wire in ways that would belie Cisco's reputation as a superefficient producer in the New Economy.

That night, at the company's main San Jose warehouse, employees scrambled to load as many boxed-up machines onto trucks as possible, thus enabling them to be counted as "sold" for accounting purposes before the quarter ran out at midnight. "We had guys running with parts, trying to run them up to the trucks," recalls Larry R. Carter, chief financial officer, who monitored the action from a computer terminal in the warehouse that tallied shipments in real time. One harried staffer, in his haste, fell headlong to the concrete floor in front of Carter. Ten minutes before midnight, Chambers called Carter's cell phone from Davos, Switzerland, where he was speaking at an economic summit. "Did we make it?" Chambers asked. After a few more minutes of watching the numbers come in, Carter

had to pass along the bad news: Cisco would undershoot expectations by a penny

per share, its first Wall Street miss in 11 years.

The news shaved 13% off the company's market value in one day, but there was worse to come. It turned out that Cisco's networked-manufacturing model was not nearly as accurate as Chambers had boasted. Only 40% of what Cisco sells is actually made by the company. Instead, a network of suppliers and contract manufacturers delivers an unusually large chunk of Cisco-branded merchandise direct to customers. This business model was supposed to keep fixed costs to a minimum, eliminate the need for inventory, and give management an instantaneous, real-time fix on orders, shipments, and demand.

The highly hyped systems, however, failed to account for the double and triple ordering by customers tired of long waits for shipments. So Cisco began to stockpile parts and finished products. "We made a conscious decision when our lead times were 12 to 13 weeks to build inventory, because

we were leaving a sizable amount of revenues on the every quarter," says Carter. Soon inventories were growing faster than sales. The result: When a weakening economy brought capital spending to a near halt, Chambers found himself stuck with billions of dollars of inventory he didn't expect to have. In April, he wrote off \$2.2 billion of excess inventory and cut 18% of Cisco's staff, or 8,500 employees.

Despite the massive write-off, Cisco still holds surprisingly high levels of finished-goods inventory: 26 days of finished inventories in October, three days more than it had in 1999 when it took its big bath of a write-down. It's just another question mark about demand for Cisco's products. David Powell, vice-president for corporate finance, calls the company's high finished-goods inventory "inconsequential" and points out that overall inventories have fallen to \$1.3 billion from \$2.2 billion in the past nine months.

To improve manufacturing and sales forecasting, Chambers says, Cisco has added new checks and balances. It now disseminates more information about demand and product log not only to contract manufacturers but increasingly to hundreds of suppliers who provide the parts for contract manufacturers. The idea: to make sure everyone works with the same information, making it less likely Cisco will see a inventory surprises. In addition, Cisco has added new ways to gauge customer demand. For instance, not only does it cut sales projections by region and business unit, it also double-checks this against monthly customer surveys expected spending up to 180 days in the future.

The inventory debacle was the first major miss Cisco had in 11 years. Indeed, there was good reason for its obsession with meeting Wall Street's expectations each quarter. The continual earnings gains kept Cisco's stock price high, which in turn allowed the company to make acquisitions and lure talent. The

WHERE C

VOICE-OVER-INTERNET SYSTEMS

CISCO'S SPIN

With more voice traffic over the Internet, Cisco believes this market can account for \$10 billion in Cisco sales in five years.

SKEPTIC'S VIEW

Cisco is well-positioned, but its projections are overblown. Companies and carriers will likely stick with their existing networks for the foreseeable future because of the downturn in capital spending.

WIRELESS-NETWORKING

CISCO'S SPIN

Cisco already boasts about 30% of the office market, expected to grow to \$3.2 billion from \$1 billion by 2005. Cisco expects this business to be a billion-plus opportunity soon.

SKEPTIC'S VIEW

Lots of entrenched competitors already in the business, making it difficult if not impossible to dominate the market as it does in other core areas.

Cover Story

THE CISCO HYPE

CIS TO GROW



STORAGE AREA NETWORKS

Cisco believes it can grab a 10% to 30% share of this fast-growing data storage in coming years. At the current size of the market, that's a big jump.

Another billion-dollar business for Cisco? It's a stretch until the network giant rounds out its still limited storage-networking products.

It explains the creative ways Cisco found to account for purchases and tally its earnings. Among the \$5.4 billion in acquisition-related charges it took in the past five years, for example, the lion's share—\$3.8 billion—covered “in-process research and development.” In some cases, these expenses nearly equaled the cost of the acquired companies. By taking these charges up front, a move that is supposed to reflect that acquired research and development may prove worthless regardless of the sum paid for it, future earnings tend to look rosier. The reason: If the technology ultimately pays off, earnings are unencumbered by their true costs, which otherwise would have been amortized as goodwill.

Like many companies, Cisco's financials have long been boosted by the use of “pooling of interest” accounting for acquisitions. Employing this accounting, Cisco significantly reduced the impact of many acquisitions on its books and avoided potentially troublesome write-downs on the

acquired assets in future years. When Cisco bought GeoTel Communications in 1999 for some \$2 billion in stock, it recorded only \$41 million for the deal on its books—roughly the amount of GeoTel's shareholders' equity. Abraham J. Briloff, professor emeritus at Baruch College, estimates that in the two fiscal years ended in July, 2000, Cisco “suppressed” a total of \$18.2 billion in costs by using this method of accounting. “It inflates their subsequent results to the extent they avoid having to charge off everything from inventories, patents, licenses, plant, equipment, and goodwill,” says Briloff. Cisco disputes Briloff's analysis, maintaining that



OPTICAL NETWORKING

CISCO'S SPIN Cisco sold about \$520 million in local fiber-optic networking gear in 2001, according to analysts, down from \$740 million in 2000, but believes it is well-positioned for an eventual upturn.

SKEPTIC'S VIEW Depressed telecom spending has badly crunched the business. It will take a long time to come back, and Cisco hasn't gained share.

do not report such unaudited numbers. The Securities & Exchange Commission recently cautioned companies and their investors about the potentially misleading metrics, warning companies that they could face civil-fraud lawsuits. “It's like students deciding the process of how they're graded so that they can always get an A from the teacher,” says Howard Schilit, who directs the Center for Financial Research & Analysis. Cisco's Carter maintains that pro forma numbers more accurately portray the company's operating results because they exclude volatile charges, such as acquisition expenses. “The more information you give investors, the

better,” says Carter. “It's sort of like ‘What do you like, vanilla or chocolate? We're going to give you both so you can choose.’”

Even the quality of Cisco's pro forma earnings is deteriorating. Well before Cisco's write-down in April, the company was relying on nonoperating income for a growing portion of its pro forma earnings. By the January quar-

ter of 2001, for instance, interest and other nonoperating income had increased as a percentage of Cisco's pro forma results for each of the past five quarters, rising from just 8.8% to 14.9%. In the latest quarter, more than a third of Cisco's pro forma earnings come not from operations but from interest and other income.

Accounting issues aside, Chambers' real test will come in the next few quarters as Cisco attempts to wring greater profits out of existing products and step into new growth areas. Given the company's valuation and its current size, Cisco will have to dominate not one or even two but several of

the success of many of its acquisitions might not have led to write-offs and could just as easily have resulted in an increase, rather than a decrease, in goodwill.

One of Cisco's most frequent accounting tactics comes up every quarter when the company directs shareholders to its unaudited pro forma earnings numbers as the best gauge of profitability. In the first quarter of fiscal 2001, for example, Cisco reported pro forma earnings of \$1.4 billion, nearly \$600 million over its net income. It arrived at that tally by excluding such ordinary and important costs as acquisition expenses and payroll taxes on stock-option exercises. In the fourth quarter, Cisco's pro forma income of \$163 million was 23 times its actual net earnings.

While liberal use of more malleable pro forma earnings is not a rarity, most high-tech stalwarts, from Microsoft to Oracle,

As the 2Q closed, the CFO oversaw a frenzied rush to cram machines on trucks so they'd be counted as “sold”

these new markets to meet its growth goals. That's no small feat given the slew of big-name competitors, from Nortel Networks to Nokia, going after these same markets. And as the corporate-networking market—Cisco's bread and butter—continues to mature, the pressure on Chambers to conquer new markets will only increase.

Cover Story

THE CISCO HYPE

The most promising growth industry could be voice-over-Internet systems. By using Internet-based phones, or so-called IP phones, a company no longer has to invest in building and servicing a separate voice network. In addition, IP users can easily combine voice and Internet features—such as accessing e-mail via telephone—since they spring from the same network. About 7% of the new underlying phone-switching systems, or PBXes, sold to corporations are Internet-based, made by companies like Cisco. That's expected to jump to 19% of the \$10 billion market by 2004, according to International Data Corp. "Voice alone could represent \$10 bil-

lion [in revenues] a year for us," in the next five years, says Volpi. Reaching \$10 billion so quickly is more than a stretch goal. After all, the overall market is tiny and Cisco's corporate customers have been slow to adopt this technology. "It's a slow road ahead," says International Data analyst Tom Valovic. The optical-networking market, pegged as another future growth engine, has much less potential. Cisco already trails a host of competitors, including Lucent, Alcatel, Nortel, Fujitsu, and Ciena. Although Cisco claims a strong position in the local rather than long-haul market of optical networking, even the local segment suffered its first-ever sequential decline in the third quarter of this year.

The wild card in Cisco's growth plans is its effort to acquire telecom companies. These massive purchasers of network gear have largely stayed loyal to traditional vendors such as Nortel and Lucent. Cisco, at its peak, was generating more revenue selling to telecoms, many of them upstart companies, than it was selling to other industries, including the growing Internet. But as many of these outfits faltered, Cisco has become more dependent on established corporations. Up-

CISCO SHOPPED TILL IT NEARLY DROPPED

It was an all-too-typical deal for Cisco Systems Inc. Monterey Networks Inc., an optical-routing startup in which Cisco held a minority stake, was a quarry with no revenue, no products, and no customers—just millions in losses it had racked up since its founding in 1997. Despite those deficits, Cisco plunked down a half-billion dollars in stock to buy the rest of the company in 1999.

But within days of closing the deal, all three of Monterey's founders, including its engineering guru and chief systems architect, walked out the door, taking with them millions of dollars in gains from the sale. "I came to the realization I wasn't going to have any meaningful impact on the product by staying," says H. Michael Zadikian, a Monterey founder. Eighteen months later, Cisco shut down the business altogether, sacking the rest of the management team and taking a \$108 million write-off.

That dismal tale hardly jibes with Cisco's widespread reputation as an acquisitions whiz. Not since the conglomerate era has a company relied so heavily on its ability to identify, acquire, and integrate other companies for growth. CEO John T. Chambers believed that if Cisco lacked the internal resources to develop new products in six months, it had to buy its way into the market or miss the window of opportunity. Some put a new name on it: acquisitions and development, a way for the company to shortcut the usual research cycle. Its belief in the strategy has led Cisco to gobble up more than 70 companies in



THE ONES THAT GOT AWAY

Cisco says it was aiming to acquire brainpower. But after many of its buys, the top talent promptly bolted

the past eight years. Analysts and academics heaped praise on Cisco's acquisitions prowess in articles, books, and business-school case studies.

In the early days, some of this praise was deserved, as Cisco morphed from a router company to a networking powerhouse. Its first acquisition, Crescendo Communications Inc., guided Cisco into the switching business, which generated \$10 billion in sales last year. All told, acquisitions have laid the foundation for

about 50% of Cisco's business.

But in early 1999, with executives enticing a growing number of unproven companies to go public, Cisco suddenly had to acquire companies at a much earlier stage. Cisco had claimed an unprecedented success rate of 80% with its acquisitions. Chambers now says it felt like 50% during the craze—still above the industry average. "We bet on products months out," concedes Chambers. "We took dramatically higher risks."

Chambers often maintained his acquisition strategy was about acquiring brainpower more than products. But an analysis of the acquisitions Cisco made in 1999 shows Monterey was no fluke. Many of its most valuable employees, the driven founders and chief executives of these acquired companies, have bolted, taking with them a great deal of the expertise and experience Cisco paid top dollar for.

The two founders of Stratix Communications Inc., a maker of high-speed semiconductors purchased for \$1 billion, left Cisco. The chief executive of Sentient Networks Corp., a call center outfit acquired for \$2 billion, left after nine months. So did the founders of WebLinc Technologies, WebLinc Communications, Tasmanian Network, Aironet Wireless Communications, and Worldwide Data Systems. high-priced acquisitions in 1999 simply felt Cisco had become complacent and too slow. "People who can't do so well at Cisco," says Networks CEO Dev Gupta, who

"[Chambers] is almost too nice to kick the asses that need to be kicked," says an old colleague from Wang Labs

only known 50% growth since taking over the helm in 1995 can stomach an environment of disciplined cost cuts and layoffs. The decision to lay off 8,500 employees last March weighed so heavily on Chambers that he mulled over its consequences on his treadmill one night at 2:30 a.m. "He's almost too nice to kick the asses that need to be kicked," says John Thibault, a former

Cisco executive and colleague of Chambers' at Wang Laboratories during the late 1980s.

If Chambers is worried about the tough decisions ahead, he's not letting on. "Last year was tremendously humbling. It knocked us on our tail. But if we execute right, our future is very, very bright," he says. "Cisco is clearly positioned to break away." Investors buying up Cisco stock at 95 times earnings are banking on it. But Chambers will need much more than bold accounting and long-shot bets on fledgling markets to deliver.

ever, continue to haunt Cisco. Paso Global Networks Co., for example, announced in October it was putting the brakes on a massive billion-dollar network, of which Cisco was slated to be the primary supplier. The reason? Just too much competition in the market.

But Cisco's struggles with carriers have gone well beyond market conditions. To get back on track, Cisco is rethinking its approach to this market. First, it is aiming nearly all of its resources on the 50 biggest carriers. Second, it's trying to mend relationships beyond the executive suite with the networking and operations people who often influence which vendors are used.

Perhaps Chambers' biggest challenge is the switch from rapid hypergrowth to grappling with issues of cost control and productivity that will restore the company to profitability. Some question whether the cheerleading CEO who has

led MaxComm Technologies Inc. in 1997 and 1999, respectively, focuses much more on immediate needs, less on high-wire technology development that customers wait two to three years out." Chambers maintains that Cisco's rates are the best in the industry. "In our industry, 40% of the top management team and peers are gone within two years," he says. "Our voluntary attrition is about 12% over two years." His only holding on to top talent is the only flaw in the Cisco acquisition machine. Cisco often paid out sums for these unprofitable acquisitions—a total of \$15 billion in 1999 when some of the deals that Chambers successful look pretty

dreadful using simple math. Its 1999 acquisition of Cerent Corp., a maker of optical-networking gear, is a good example. Cisco paid \$6.9 billion for the company, or \$24 million for each of Cerent's 285 employees, even though the company had never earned a penny of profit and had an accumulated deficit of \$60 million. Even if earnings bounce back to 2000 levels of roughly \$335 million, it would take Cisco about 20 years to recoup the purchase price.

Of course, deals such as Cerent found their rationale in Wall Street math. If investors were willing to pay 100 times earnings for Cisco's stock in 1999, then a Cerent profit of, say, \$300 million could effectively increase the market cap of Cisco by some \$30 billion. Call it bubble economics. Besides, many of

these deals were done for highly inflated Cisco stock instead of cash. Even so, that wampum could have been used to buy other assets that could have delivered greater returns.

Only in the months since the bubble burst has it become evident just how muddled Cisco's mergers-and-acquisitions strategy became. In its haste to do deals, Cisco often purchased companies it didn't need or couldn't use. In some cases, the buying spree led to overlapping, duplicative technologies, political infighting, and just plain wasted resources, as Monterey shows. "M&A works to some extent, but at Cisco, it got out of hand," says Iqbal Husain, a former engineering executive at Cisco.

After losing many of the leaders of these businesses, product delays and other mishaps were not uncommon. When Cisco closed down Monterey, for example, the company still hadn't put a product out for testing, which alone would take as long as a full year. "By the time the product was there to test, the market wasn't," says Joseph Bass, former CEO of Monterey.

Chambers says he has moved to correct the flaws. Its acquisition binge has slowed—from 41 companies from 1999 through 2000 to just two purchases in 2001. While Chambers expects to do 8 to 12 acquisitions this year, he insists that market conditions will let Cisco wait at least until a target company has a proven product, customers, and management team before cutting a deal. "We're making the decisions to acquire a company based on a later point in time, which dramatically lowers the risk," Chambers says. Anything more ambitious, Cisco now knows, may be foolhardy.

By John A. Byrne and Ben Elgin in San Jose, Calif.

A COSTLY ACQUISITION STRATEGY

Included for its buyout successes, Cisco has purchased more than 70 companies in the past eight years. In 1999 alone, it paid \$15 billion for 18 startups, many of which never delivered on their early promise. Here are the most noteworthy:

PRICE	STATUS	SKINNY
\$6.9 billion	Alive and well	Although Cerent has generated \$1 billion in estimated sales for Cisco, two decades could be needed to recoup the steep price.
\$2.2 billion	Alive but struggling	A disappointing attempt to bolster Cisco's long-haul optical networking. But Pirelli's technology still trails that of rivals.
\$500 million	Dumped in April	This upstart optical company never produced a viable product, and Cisco cut its losses with a \$108 million write-off in April.
\$170 million	Sold at a loss in July	Lackluster revenue forced Cisco to sell this unified-messaging business.
\$143 million	Part of their DSL strategy	Founders and key technologists walked out soon after the deal closed.

Data: BusinessWeek

BANKING

THE PERILS OF J.P. MORGAN

Enron, Argentina, the bear market—a year after the merger with Chase, the bank is racking up losses

When Chase Manhattan swooped in to bid \$33 billion for white-shoe investment bank J.P. Morgan in September, 2000, Chief Executive William B. Harrison Jr. claimed that the new behemoth would provide “huge” growth. The idea was simple: Thousands of Chase’s corporate customers would be pushed into J.P. Morgan’s arms and pay fat fees for takeover deals, securities issues, and the like. Nor was the strategy far-fetched. After all, Citibank and Travelers Group had successfully combined in 1998 to produce a bull-market juggernaut that was leaving rivals, including Chase, in the dust.

The reality has turned out to be a lot different. Instead of striking the new gusher of profits promised by Harrison, the merged J.P. Morgan Chase & Co. has tapped into a seemingly endless well of red ink. As a result, the new bank is ending its first full year by taking huge write-downs and making expensive additions to loan loss reserves. Analysts figure anything from \$800 million to over \$2 billion will be sliced off the fourth-quarter operating earnings to be announced on Jan. 16. Piled on top of second-quarter charges of about \$1 billion, net income for 2001 could drop as low as \$3.5 billion, down from the \$5.7 billion that J.P. Morgan and Chase Manhattan together earned in 2000.

Admittedly, 2001 was the worst year for investment banking in nearly a decade. Mergers and acquisitions dried up, as did stock offerings and syndicated lending. Moreover, as the global economy worsened and the bear market dragged on, corporate lending and private equity took major hits as well.

More than bad luck with the timing

of its merger could be dogging J.P. Morgan, however. Some analysts argue that the bank regularly runs much bigger risks than its rivals and is now paying the price. The bank’s exposure to bankrupt energy trader Enron Corp.’s loans, and energy and derivatives contracts, has grown to \$2.6 billion. It has \$900 million in exposure to Argentina and its \$117 billion commercial loan portfolio is facing a series of high-profile losses—thanks to bankruptcies among its telecom customers, as well as Enron. The value of its private equity portfolio, the largest of any U.S. bank, has been a major drag on earnings since the Nasdaq crash in March, 2000. And analysts

have started to worry that the bank’s off-balance-sheet assets could be a future source of losses. “I think their profile is greatly understated,” Charles Peabody, an analyst with independent researcher Ventana Capital.

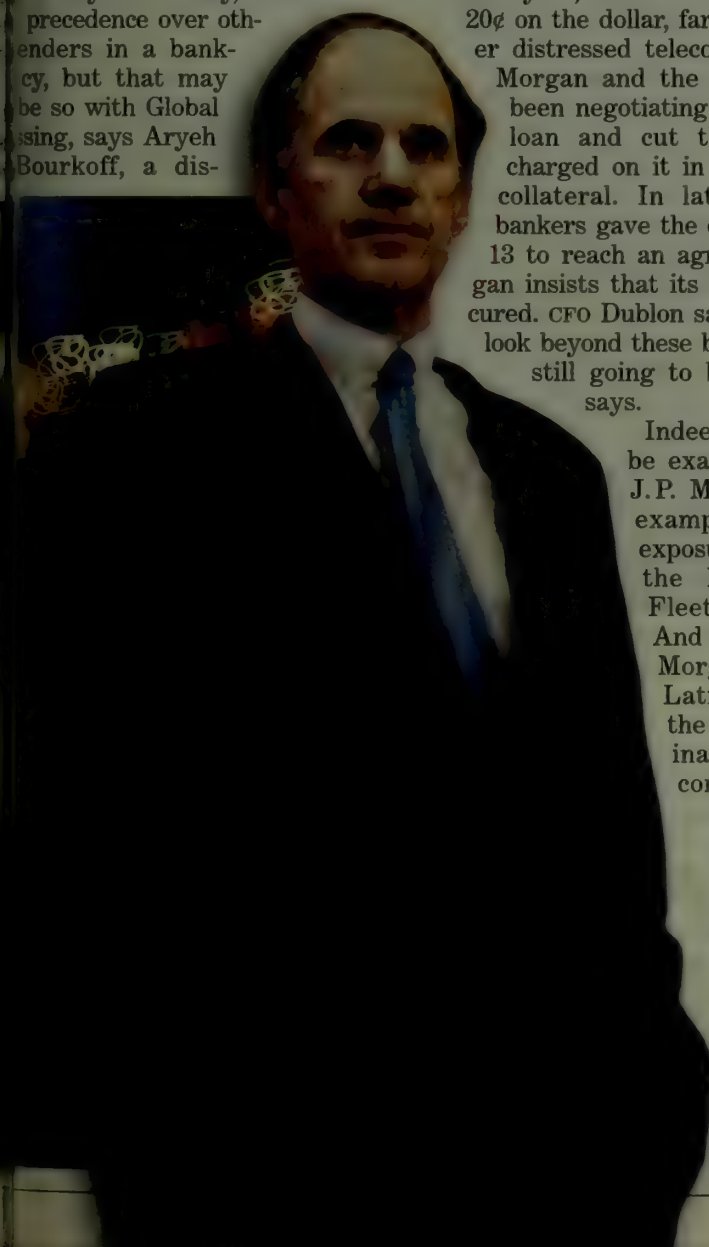
J.P. Morgan executives balk at suggestion they deliberately court risks than their peers. They argue investors and analysts are punishing the bank because it has been more scrupulous about reporting potential losses. The company’s stock has sunk 22% since the merger was announced in 2000. “We’re a lightning rod for credit loss because we’ve been more up-front than other participants in the market,” Chief Financial Officer Dina Dublon added. J.P. Morgan has been more than others in some matters. It posted its private equity portfolio online. And it told analysts about its Argentina exposure when the country careened toward default. Citigroup, by contrast, does not detail its private equity holdings. J.P. Morgan has not given details on its exposure to Argentina, which analysts estimate at \$1 billion, beyond saying that country losses represent less than 2% of earnings.

Still, it’s unnerving how the bad news keeps piling up at J.P. Morgan. Because the bank was one of the largest lenders



Enron, as well as an adviser in the failed Dynegy Inc. takeover bid, analysts weren't surprised when it announced on Nov. 28 that it had \$900 million in exposure to the energy company. The real shocker was the disclosure on Dec. 19 that the bank's unsecured exposure to Enron had tripled, to 1.6 billion, after insurers failed to come good on nearly \$1 billion in guarantees on Enron gas contracts. Called "Mahonia Natural Gas," a J.P. Morgan "special purpose vehicle" created to handle commodity contracts with Enron. The bank is suing the nine insurers to force them to pay up, but they are fighting back. Meantime, analysts say the belated disclosure has hurt the bank's reputation.

Corporate lending problems don't end there. J.P. Morgan and Citi assembled a group of banks that lent telecom company Global Crossing Ltd.—now deeply troubled—more than \$2.2 billion in its earlier days. Normally, banks have precedence over other lenders in a bankruptcy, but that may not be so with Global Crossing, says Aryeh Bourkoff, a dis-



Risky Exposure	
TROUBLED COMPANIES	
ENRON	\$2.6 BILLION
NTL CABLE	900 MILLION
GLOBAL CROSSING	95 MILLION
ARGENTINA	
	\$900 MILLION
VENTURE CAPITAL WRITE-DOWNS	
	\$250 MILLION-\$700 MILLION
Fourth quarter Data: BW company reports; Fox-Pitt Kelton; U.S. Bancorp.	



BUENOS AIRES UNREST: LOTS OF LOANS, MAINLY TO BIG COMPANIES

tressed-debt analyst at UBS Warburg. Because of the way the loan is structured, he says, other creditors could be paid first if Global Crossing goes under. The point isn't academic: Global Crossing lost \$1.9 billion on revenues of \$2.4 billion in the first nine months of last year, and its bank debt sells for 20¢ on the dollar, far below that of other distressed telecom companies. J.P.

Morgan and the other banks have been negotiating to stretch out the loan and cut the interest rates charged on it in exchange for new collateral. In late December, the bankers gave the company until Feb. 13 to reach an agreement. J.P. Morgan insists that its loan is, in fact, secured. CFO Dublon says analysts should look beyond these black marks. "We're still going to be profitable," she says.

Indeed the market may be exaggerating some of J.P. Morgan's risks. For example, its Argentina exposure is smaller than the likes of Citi or FleetBoston Financial. And Brian O'Neill, J.P. Morgan's chairman of Latin America, says the loans are predominantly to large commercial and in-

dustrial enterprises, many of them subsidiaries of foreign companies and therefore less likely to be affected by the peso devaluation.

Still, there's more bad news ahead. J.P. Morgan Partners, the bank's private equity unit, will need to write down \$100 million on its investment in telecom outfit Triton PCS Inc. And losses could be even more severe in its \$8 billion portfolio of privately held companies. Fox-Pitt Kelton analyst E. Reilly Tierney expects the unit will have to take \$600 million in write-downs for the last quarter of 2001. Further losses are likely from the bank's off-balance-sheet dealings. It founded, and is by far the largest market maker in, the \$1 trillion market for credit derivatives, a form of loan insurance. Issuers of these derivatives lose money if insured borrowers don't repay their loans. In the third quarter, banks lost \$99 million in derivatives, says the Office of the Comptroller of the Currency. Nearly all of that—\$95 million—was borne by J.P. Morgan alone, says Ventana's Peabody, who expects more losses to come. J.P. Morgan's head of credit derivatives, Andy Brindle, says the bank made substantial profits on its overall derivatives portfolio in the first nine months of 2001, while losses are on credit derivatives were "insignificant."

The litany of woes at J.P. Morgan seems endless. Bank executives remain philosophical that times are bound to be tough when the economy tanks. "Extending credit is the business we're in, and we're at the point that credit losses are going higher," says Dublon. There's no arguing with that. But sooner or later, the brass are going to have to make good on their boss's promises of future growth to placate critics.

By Heather Timmons in New York, with Christopher Palmeri in Los Angeles

BAD TIMING
CEO Harrison foresaw a merger as successful as the Citibank-Traveler's deal. So far, though, it hasn't worked out that way

BANKING

WHIPPING A BEHEMOTH INTO SHAPE

CEO Lewis is slimming BofA, but can he improve profits?

As a top lieutenant at Bank of America, Kenneth D. Lewis was Mr. Fix-it for CEO Hugh L. McColl Jr.'s many problematic deals. So when McColl passed the baton to Lewis, a 32-year bank veteran, in April, 2001, many investors feared he'd preserve his mentor's legacy—without fixing the earnings shortfalls that were McColl's hallmark.

But to Wall Street's surprise, the 54-year-old Mississippian wasted no time moving out of McColl's shadow. In contrast to his predecessor's grow-at-all-costs approach, he has shrunk the Charlotte (N.C.) bank with a vengeance. His goal: to generate more profits from its chronically underachieving franchise, which now serves 2 million businesses and 30 million households. To do so, Lewis has shed underperforming businesses, beefed up customer service, and brought in new managers. And to appease the bank's shareholders, he recently boosted BofA's dividend by 7% and mapped out plans to buy back 8% of the bank's shares.

As a result, Wall Street is giving Lewis the vote of confidence that McColl never received. BofA's stock has risen 37% since the start of 2001, to \$61.95. It had fallen to \$36 a share in 2000 from a high of \$76.80 in July, 1998, after news that McColl's NationsBank Corp. and San Francisco-based Bank of America would merge. "There's a quiet revolution taking place at Bank of America," says Prudential Securities Inc. analyst Michael Mayo. "Lewis is shifting the focus from empire-building to value creation."

Lewis dismisses any notion that he's dismantling McColl's empire, which became the nation's third-largest bank institution behind Citigroup and J.P. Morgan Chase & Co. "We had a certain time to gain size and scale to become a survivor," says Lewis. "We had the right model for the times." Still, the bank

never achieved the breakout profits that McColl promised because of the difficulty in integrating such acquisitions as Boatman's Bancshares, Barnett Banks, and Montgomery Securities, a \$1.2 billion buy that soured when the majority of Montgomery's investment bankers defected. Sean J. Ryan, an analyst at the independent research firm Fulcrum

such as auto leasing, and walked from scores of customers, including likes of Wal-Mart Stores Inc., whose business wasn't very profitable for BofA. Together the moves have shrunk the bank's balance sheet by \$40 billion since mid-2000, to \$640 billion.

Lewis is also tackling the bank's lousy customer service. He upgraded training programs, organized services around types of customers rather than product lines, and tied executive salaries to targets for cross-selling more products. At the same time, he's infused the bank with fresh blood. He added three outsiders, including ex-Olympic executive Peter V. Ueberroth and former Lee CEO C. Steven McMillan, to the bank's clubby board. And he broadened McColl's circle of longtime advisers to nearly two dozen marketing and

SHAKE-UP

How Ken Lewis is remaking Bank of America

LESS IS MORE The bank has jettisoned underperforming operations such as auto leasing and high-risk mortgages and has closed some corporate banking accounts

BETTER SERVICE Lewis is instituting new teller training programs and other initiatives designed to boost customer service

NEW BLOOD The company has recruited nearly two dozen new executives and added three outsiders to its board



Global Partners LLC, estimates that net operating income in 2001 rose less than 2%, to \$4.80 per share—a third lower than McColl predicted at the time of the BofA deal. U.S. bank earnings are expected to rise 5% on average.

Improving earnings will be tough in an economic downturn marked by an industry-wide ballooning of bad debts. For 2002, Ryan expects a 9% rise in profits—in line with other banks—to \$5.25 per share, excluding a 40¢ gain from new goodwill accounting rules. Lewis says he has no appetite for "large dilutive deals." So a rumored merger with Merrill Lynch & Co. is unlikely. Instead, Lewis is wielding the knife. He has retired \$26.5 billion of costly debt, quit low-margin businesses

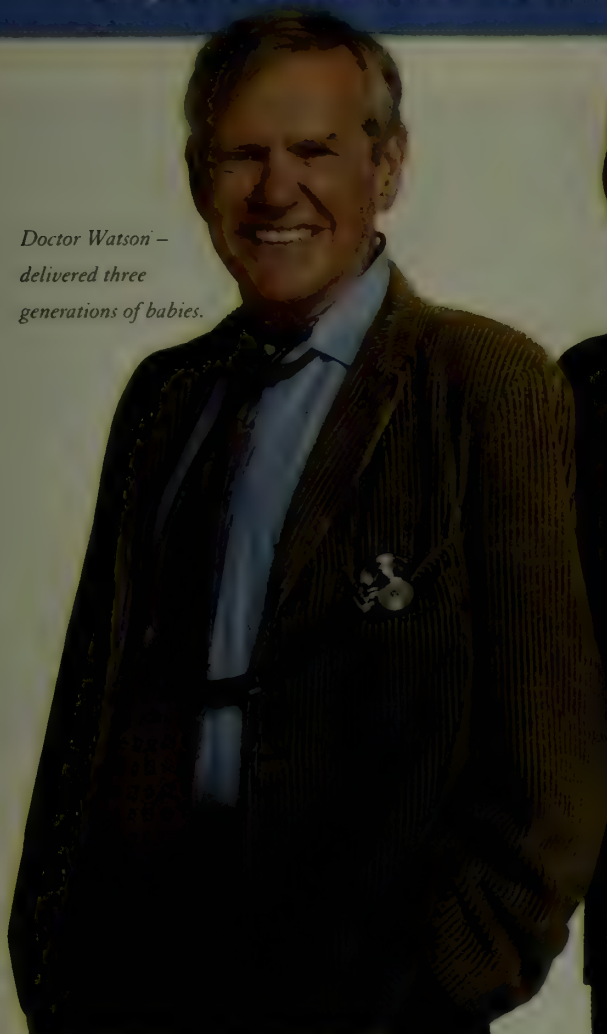
nology executives from such places as Eastman Kodak Co. and FedEx Corp. "If we're going to achieve our goals, we're going to need more than a handful of bankers to do the job," he says.

Bankers still have their uses. BofA's team made a big bet in the late 1990s that interest rates would fall. Net income, half the \$638 billion gain in net interest income that the bank booked in the third quarter came from interest-rate swaps. Some analysts say BofA's profits could be vulnerable if rates rebound quickly, though the bank says it has unwound those swaps and is ready for an upturn. Still, if Lewis can't produce the earnings shareholders want, he may have to turn off his Mr. Fixit skills again.

By Dean Foust in Atlanta

Both are seen as pillars of trust.
Only one can assess the health of your portfolio.

*Doctor Watson –
delivered three
generations of babies.*



*Kathleen Hastings
Schwab Investment Specialist,
McLean, VA*



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CHARITIES

THE SORROW AND THE PURSE STRINGS

Getting money and services to September 11 victims isn't easy

On a cold afternoon in late December, Robert J. Hurst strode into a meeting geared up to do right. The Goldman, Sachs & Co. vice-chairman had just volunteered to be chief executive of the 9/11 United Services Group. His job: to make sure 9/11's 13 agencies speed money and services to victims of the September 11 terrorist attacks. It's a daunting task. The charities, including the Red Cross and Salvation Army, hold over half the \$1.4 billion in donations.

The Dec. 20 session was his first with Give Your Voice, a group of about 1,600 victims growing more frustrated each day they dealt with the charities. Their representative, Patrick Cartier, who lost a brother at the World Trade Center, got to the point: Bereaved families weren't getting the help they needed. In fact, several feared they would go broke over the holidays.

Charged with cutting through red tape, Hurst and Monsignor Kevin Sullivan—chairman of the new group and executive director of the Catholic Charities of the Archdiocese of New York—pledged immediate action. Then...nothing. Hurst and Sullivan claim that, after the meeting, they never heard from Cartier, who says he left one message and gave up, discouraged. A classic office snafu, but with a sad result: No one in Give Your Voice got a dime after the talk with Hurst and Sullivan. Sullivan called Cartier on Jan. 4, right after a reporter inquired about the case. "We are very committed to trying to help," says Hurst.

No doubt. Still, the incident highlights the sensitive nature of the task faced by the well-intentioned Hurst. At 56, he could be concentrating on finishing a long career on a high note. Instead, he has become the point man for one of the most difficult aspects of New York's recovery.



ROBERT J. HURST

BORN 1945, Queens, New York

EDUCATION B.S., Clark University; MBA, Wharton

DAY JOB Vice-Chairman, Goldman, Sachs & Co.

VOLUNTEER GIG Since December, 2001, CEO, 9/11 United Services Group, coordinating 13 charities for victims of terrorist attacks

WHY HE TOOK THE 9/11 JOB "I'm a New Yorker. I wanted to do more than give money."

BIGGEST CHALLENGE Satisfying embittered victims

September 11 started a tidal wave of donations for the estimated 200,000 people who were injured or lost relatives, jobs, or homes in the attacks. Yet the funds might be wasted without oversight: Victims claim they keep filling out forms but never get assistance. In response, New York State Attorney General Eliot Spitzer created Hurst's group.

Hurst got the job partly because of his negotiating skills. He has pulled off some of Goldman Sachs's biggest mergers and helped nonprofits—including a long list of arts groups and social service agencies—by serving as a board member or trustee. "He is able to see all sides of an issue and bring people to-

gether," says Henry M. Paulson, Goldman Sachs's chief executive.

It's no socialite charity. Hurst he's juggling both jobs from 6 a.m. 9:30 p.m. every day. With six new employees and help from IBM and consultant McKinsey & Co., he is building a database to ensure that victims get overlooked or receive duplicate services. Trouble is, many nonprofits have scant records, and what they have is often on paper. Even so, the database already has over 40,000 requests for help.

The toughest part of Hurst's job is rebuilding trust between charities and victims by cutting bureaucracy and improving communication. "The big surprise to me has been the gulf between perception and reality," says Hurst. Despite criticism of the charities, "there has been an enormous commitment," Hurst estimates that the agencies in his group have spent out \$425 million. The Red Cross told Hurst that it has distributed about 10 million meals and met with 150,000 people one-on-one. Another agency, LifeNet, has handled 20,000 calls for mental health referrals, double the volume of a year ago. Still, some claims are questionable: One small agency said it helped "hundreds of thousands" of people on its own.

Why would anyone want this assignment? "I wanted to do more than give money," says Hurst, an engineer's son who was born in Queens, N.Y., where he earned his MBA at 22. His new job is as demanding as the investment banking business. With intense media coverage of victims' complaints, Hurst is under pressure to produce results. "The nature

of this project, which requires a fast startup, is very appropriate to the situation," Bob brings to the task," says Sullivan, the group's chairman.

Hurst knows he must build a system that can function for years. After taking the job, he flew to Oklahoma City where 168 people died and 853 were injured in the 1995 Murrah Federal Building bombing. Seven years later, many victims still seek services and medical care. "Ten years from now," says Hurst, "we will still have people who need help." That's why it's so urgent to bridge the chasm between the victims and their would-be helpers.

By Emily Thornton in New York

How fast can I deploy your critical apps from Microsoft, i2 and SAP?
How fast can you plug me in?



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ON TO THE LIVING ROOM!

Can Microsoft control the digital home?

Meander through the corridors of Building 50 on Microsoft Corp.'s campus and you might, for just one mind-bending moment, feel as if you're in the bowels of consumer-electronics powerhouse Sony Corp. In one room, engineers are ginning up a way to record TV programs on a PC so they can be watched at any hour. Around the corner, workers are noodling over software that makes it a snap to edit home movies and copy them onto a DVD. Still others are figuring out better methods for managing thousands of digital music files. And in the main conference room, rather than the typical corporate white boards, there is a wall-size viewing screen and a sound system that would make the neighbors call the cops—if you dared to have one in your home.

Is Microsoft, the no-nonsense king of PC software, having a midlife crisis? Not at all. The software giant is trying on a new persona for a new environment. With PC sales expected to decline for the second straight year as corporate spending withers, Microsoft is aiming its big guns on entertainment goodies for the home. It's spending more than \$2 billion building and marketing its new Xbox game console. And it's sure to spend millions more on everything

from its UltimateTV video-recording service to an online subscription music service to a handy wireless electronic tablet for the home, code-named Mira. On Jan. 7, at the Consumer Electronics Show in Las Vegas, Chairman William H. Gates III revealed Microsoft's next-generation technologies aimed at making the PC the electronic hub of the digital home. They'll route music, movies, TV programming, e-mail, and news between the Web and PCs, TV set-top boxes, gadgets, and stereo speakers. "Everything in the home will be connected," predicts Gates. And if he gets his way, most of the gizmos will use Microsoft software.

That's why Building 50, brand-spanking new, is the digs for the software maker's eHome division, a skunk works of more than 200 engineers responsible for turning Microsoft into the Sony of the 21st century. The digital home is the biggest market push by Microsoft since it launched its assault on server computing a decade ago, and the front-line troops are stoked. Says J. Allard, one of the architects of the company's Internet strategy and now the lead technologist on the Xbox: "This is a way to build a whole new Microsoft."

And perhaps a whole new industry. In the next half-decade, Microsoft hopes

to spark a revolution in consumer technology that transforms people's home lives every bit as much as the PC changed their work lives. The concept is far from new, but Gates and other execs say the timing is right now: the Internet has made many consumers more tech-savvy. Indeed, other computer companies are doing the same—Seagate Technology, which is marketing storage devices for consumer electronics, to Apple Computer Inc.,

MICROSOFT HITS HOME

With its software entrenched in home offices, Microsoft is aggressively reaching into the living room. Here's how its strategy stacks up:

GAME CONSOLES

Microsoft leapt into this \$20 billion market in a big way with its Xbox launch in November. The company hopes to leapfrog rivals with online gaming that lets players compete from anywhere.

OUTLOOK FAIR

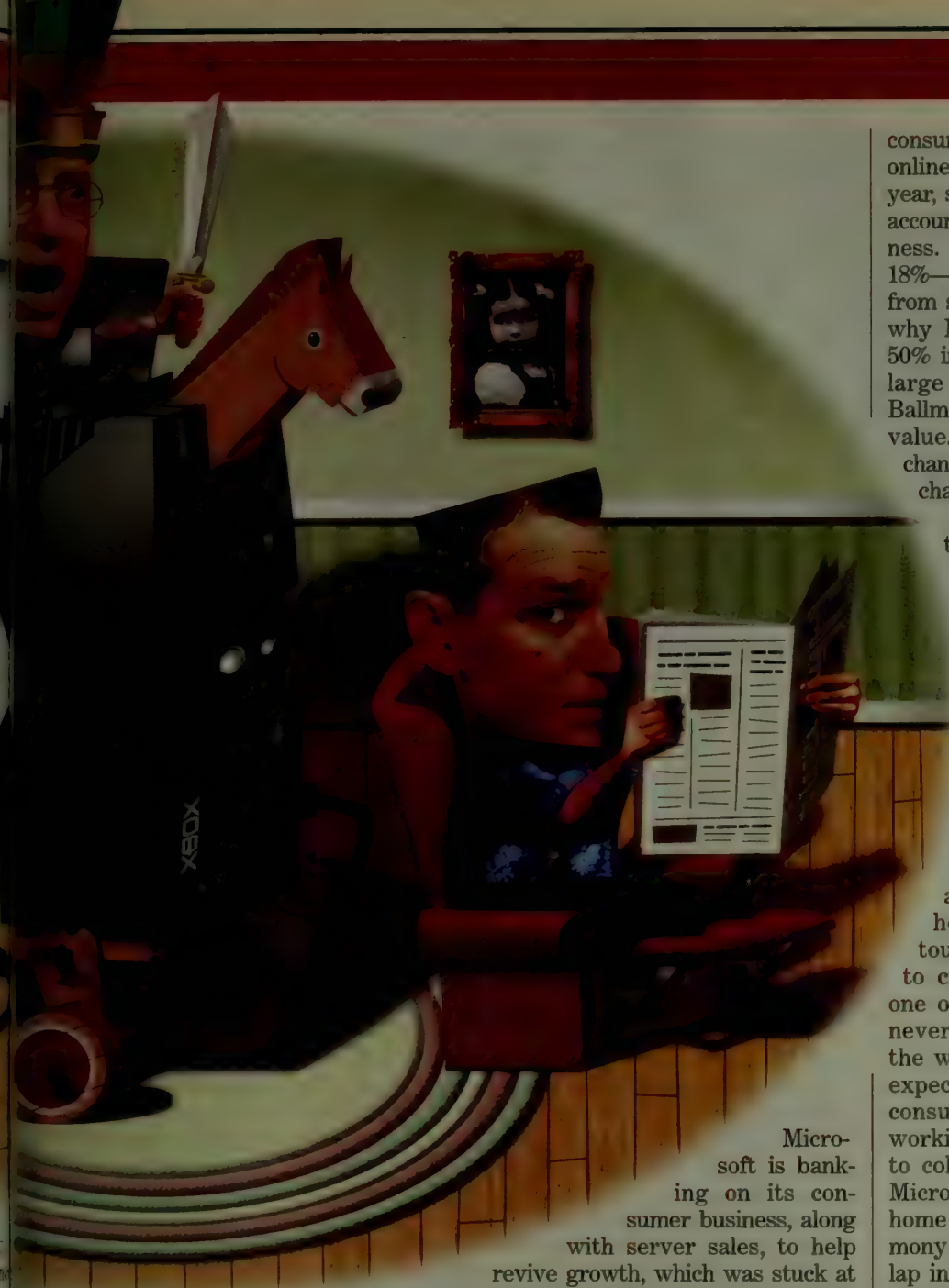
Xbox is off to a glitchless start, but Microsoft hopes to capture 40% of the market in five years—a tall order, since Sony is No. 1. Analysts expect Microsoft to grab less than 25% of the market.

ONLINE SERVICES

The company is aggressively developing paid subscription services on the Web that will let users do everything from downloading music to synchronizing their banking and investment accounts.

OUTLOOK FAIR

Microsoft is the industry leader in the consumer Web world today. But with 10 million online access subscribers, Microsoft's 7 million, AOL has a hand on the consumer's wallet.



consumer sales, which include the MSN online service, Xbox, and games. This year, sales from the consumer group will account for 12% of Microsoft's total business. In fiscal 2003, that will jump to 18%—just shy of the 21% that's expected from server products. That's one reason why Microsoft's stock is up more than 50% in the past year, to \$70. "This is a large market," says CEO Steven A. Ballmer. "There's a great chance to add value. And anytime there's a great chance to add value, there's also a great chance to make money."

The consumer push comes at a time when the company seems to be coming out from under the cloud of its antitrust woes. Unless nine dissenting state attorneys general succeed in beefing up the remedies, a settlement with the Justice Dept. and nine other states will do little to prevent Microsoft from using the power of its Windows desktop monopoly to help it win new battles in the consumer realm.

For all of Microsoft's power and ambitions, though, the digital home may turn out to be the toughest market it has ever tried to crack. At best, Microsoft will be one of several top players, but it will never dominate digital entertainment the way it does PC software. Analysts expect the markets for video games, consumer online services, home networking, and interactive TV software to collectively top \$63 billion in 2005. Microsoft could win in areas such as home networking, where its PC hegemony gives it an advantage. But it will lap in markets such as video game consoles and online services, where entrenched rivals rule.

Indeed, AOL Time Warner Inc. has a huge lead in the online service business with 33 million subscribers to Microsoft's 7 million. And Sony may be even harder to beat. The world's leading consumer-electronics brand, Sony makes

Microsoft is banking on its consumer business, along with server sales, to help revive growth, which was stuck at about 10% for much of last year. Morgan Stanley Dean Witter & Co. estimates that Microsoft will earn \$9.3 billion in the fiscal year that ends on June 30, on revenue of \$28.8 billion. In fiscal 2003, it expects Microsoft's earnings to climb to \$11.7 billion on sales of \$32.7 billion. Much of that growth will be driven by

ated its new iMac for the home on 7 (page 72). Says Gates lieutenant Bert J. Bach, who oversees the Xbox up: "The technology revolution has changed the way people do business. The next 5 to 10 years will be the dig-entertainment revolution."

HOME NETWORKING

is building links in every piece software in order to make PCs, set-top boxes, stereos, and handheld devices talk to each other.

OK Reliable networking requires software, and that's Microsoft's strength. Microsoft is the only company with both the software expertise and the hardware to make home networking prolific.

PCs

Microsoft has combined ever-more consumer offerings into the newly minted Windows XP. That has made it easier to do everything from organizing music files to gathering digital photos.

OUTLOOK GOOD

Microsoft's strength on the PC is insurmountable. Windows ships on 95% of all PCs sold. That gives Microsoft a huge entrée into consumers' homes, where it can pitch its other products and services.

INTERACTIVE TV

Microsoft is aggressively hawking its set-top box software to cable operators, hoping to put its technology at a crucial gateway to the Web.

OUTLOOK POOR

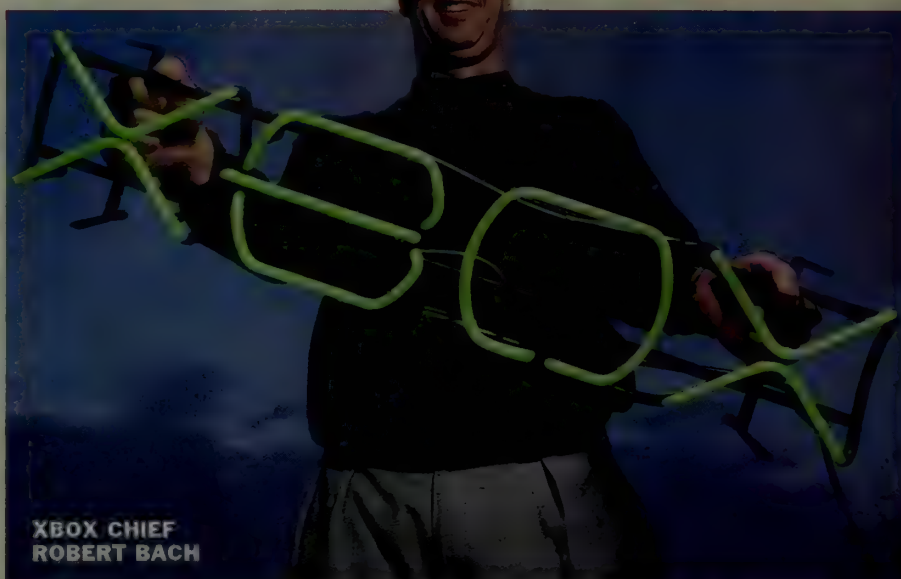
Microsoft is still losing ground to its chief rival, Liberate Technologies, in the market for software for TV set-top boxes. Several cable companies that Microsoft invested in chose rival software rather than waiting for Microsoft to get it right.

every key piece of hardware—from PCs to set-top boxes to game consoles. Microsoft's focus is primarily the software that goes inside the machines, and so its success depends, in part, on the smarts of its hardware partners. "Ultimately, it's the hardware that provides the great consumer experience," says Sony President Kunitake Ando.

Moreover, Microsoft has been missing the consumer gene for years. All of its major consumer-electronics gambits so far have ended up as disappointments. Its WebTV Internet-access service stalled at 1 million subscribers, and its interactive-TV technologies have gone nowhere. The company's digital stereo speakers and PC-connected telephones were introduced in 1998 only to be abandoned a year later. And the gee-whiz technology in Gates's suburban Seattle mansion—which includes electronic pins that each person wears to signal a preference in digital art, music, and temperature—has required as many as 50 servers, not the stuff of a simple consumer experience. Says Minoru Arakawa, who retired on Jan. 8 as the president of Nintendo of America Inc.: "Microsoft is spending a lot of money, but they are beginners."

Even Microsoft's allies are tinkering with rival software, not convinced that Microsoft will be the end-all in the digital home. Microsoft buddy Intel Corp. has used non-Microsoft software in some of its Web appliances. "There will be a lot of experimentation," says Intel CEO Craig R. Barrett. While he thinks the PC can be a hub for home networking, in some cases it will be on the periphery. One alternative to the PC emerged on Jan. 7 when startup Moxi Digital Inc. debuted a system for managing home entertainment via a set-top box.

Microsoft is playing to win, though. It's going about this with the patient, war-of-attrition approach that has been so successful in the past. The seeds of this assault were planted in March, 1999, when Microsoft execs gathered



**XBOX CHIEF
ROBERT BACH**

Even if it gets the technology right, Microsoft faces such formidable foes as AOL Time Warner and Sony

at a retreat on the shores of Puget Sound to ponder their strategy for the home. Gates, Ballmer, and Bach wondered if they could build a new generation of consumer devices based on PC technologies.

Around the same time, a handful of engineers deep inside the company wanted to build the hottest-ever game console. Nat Brown, one of the ring-leaders, recruited Allard to get behind the project during a day they spent together playing video games at Allard's cabin in the Cascades. "The heart and soul of this thing came from the garage—5 to 10 dreamers who wanted to take Microsoft into a new space," says Allard.

Microsoft's brass decided to attack on all fronts. Microsoft seemed to turn the corner at the 2000 Consumer Electronics Show when it abandoned its tradition of setting up a series of booths to market its products. Instead, it created a model home on the showroom floor—complete with Jetson-like gadgets and a family of actors—to show people how digital technologies might shape their future. "That's when the whole company got the 'aha!'" says Microsoft consumer products strategist Craig J. Mundie.

Microsoft decided it would build off what it sees as its "three pillars" for the digital home: MSN, Xbox, and Windows XP, which includes home networking technology. That way the software giant can leverage its strengths

being the best. They all had to be the best before the whole integration came together."

Although Gates says no detailed exists for integrating all these products, Windows and the PC are central to the strategy. That's why Windows XP, the newest version of the company's operating system, is so important. After years of producing crash-prone software, Microsoft finally delivered an operating system that more like a consumer appliance. Launched on Oct. 25, XP seldom crashes and is easy to use. With XP, it's a snap to edit home movies or burn programs that are likely to greatly expand the use of the PC in the home. And Windows XP's home networking technology lets the PC automatically discover and connect such network devices as digital audio receivers. "We're moving Windows to the living room," crows James E. Allchin, vice-president in charge of Microsoft operating systems.

Microsoft also is taking a page from its past playbook: It's creating an ecosystem in which hardware makers and software developers can create products based on Microsoft technology. "We have partners who are doing keyboards and screens and lots of peripherals that will let you reach out to all the different things around the home," Gates says. Already signed up: Samsung, Hewlett-Packard, and NEC,

into new home entertainment categories such as online retail. The plan now is to create special products in a range of markets rather than try to build an uber-box that would handle everything from games to spreadsheets. Microsoft teams are pursuing separate attacks on game consoles, consumer interactive TV, and home appliances and handheld gizmos and online services. The way you get to the vision is by building individual products that are the best in their own category, says Gates. "It's Microsoft Office built that with being the best,

are developing media center PCs use eHome technology.

These PCs will use a Microsoft software code-named Freestyle. In addition to peripherals such as a mouse and keyboard, PCs loaded with Freestyle would include a TV tuner to connect to a cable service and a remote control to navigate the system from a couch. That way, consumers could organize their music files or home movies while they're sitting at a desk. Later, use the remote control to set tunes or videos from anywhere in the room. The first-generation, all-in-Freestyle PCs will have all the functionality of a TV and a stereo. The target market: college students and apartment dwellers who might not have the space or budget for a PC, a TV, and a stereo. The second-generation Freestyle PCs will focus on the broader consumer market, selling boxes that connect to TVs around the house and connect back to the main PC.

The first major connected-home product from Microsoft will be a gizmo code-named Mira. By next Christmas, consumers will be able to buy a flat-panel monitor that detaches from its stand and continues to connect wirelessly to a PC from anywhere in the house. With a stylus tapping icons or scrawling letters on a touch screen, Mom can check e-mail from the kitchen, the kids can chat with online buddies from the couch while watching MTV, and Dad can surf at Amazon.com from the back porch. ViewSonic Corp. and Wyse Technology Inc. will make the devices for less than \$500.

Microsoft is counting on Xbox to jump-start its digital home initiative. Already, Xbox sales are hitting the high end of analysts' expectations. Since the launch on Nov. 15, about 1.5 million consoles have been sold. That beats Nintendo's Game Boy Advance, which has sold 1.2 million units since its Nov. 18 launch. Meanwhile, Sony's PlayStation2, out since Oct. 25, has rang up 2.5 million unit sales in

North America this Christmas season.

Even the bookish Gates has been sucked in by Xbox. Although he was never much of a gamer before, he took a test version on his vacation in October. Each night, after putting their two children to bed, Gates and wife Melinda plopped down on the couch and found themselves absorbed by Fuzion Frenzy, a collection of 45 arcade-style games. "We played four hours straight the first day, since it was so cool," says Gates.

While Xbox is designed first and foremost to best PlayStation 2 and GameCube, the connected-home vision is a constant undercurrent. Microsoft built networking technology into the Xbox that will let gamers compete against one another from across

the street or around the world. The company plans to launch its Xbox online gaming service by the middle of this year. Robert A. Kotick, chairman and CEO of Activision Inc., the No.2 game publisher, believes online tournaments will be immensely popular. "It's a lot of fun to waste time playing video games. It would be a lot more fun wasting time playing video games and winning a trip to Hawaii as well," Kotick says.

For all the nifty technology, Xbox still needs killer games. And analysts don't count any sure blockbusters in the initial bunch of 20. "What's the must-have game that's going to get people to pay \$300 to buy this console? I just haven't seen it," says analyst Edward Williams of Gerard Klauer Mattison & Co. He

expects Xbox to capture about 10% of the game console market during the five-year life cycle of game consoles that's just beginning. So, while Xbox could become a sizable business for Microsoft, it's only a piece of the puzzle.

The companies that win biggest in the home will likely be the ones with the most direct ongoing relationships with customers. Right now, that's AOL Time Warner, which touches 46 million subscribers with its online and cable businesses. "The value is in the consumer relationships, not the technology. It's about subscriptions," says AOL Time Warner Co-Chief Operating Officer Robert W. Pittman. AOL is collecting \$24 a month from most of the 33 million consumers who connect to its online service. And its Time

Warner Cable unit gets another \$54 per month, on average, from its 12.7 million homes. Microsoft can't touch that. It's lucky if it sells a home PC user a \$90 operating-system upgrade every three or four years.

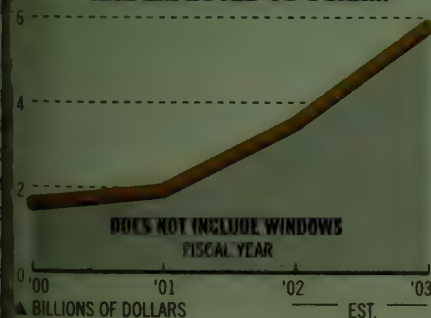
And when it comes to mastering consumer technology, Microsoft sucks Sony's exhaust. As cool as Microsoft's Freestyle sounds, Sony already has introduced its Vaio MX media center PC, which does everything that Freestyle aspires to. Microsoft's Mira is nearly a year away. But more than a year ago, Sony introduced its Airboard in Japan, a flat-panel screen that can be used to check e-mail, surf the Web, and play video games. And Sony is developing networking technology, dubbed Feel,



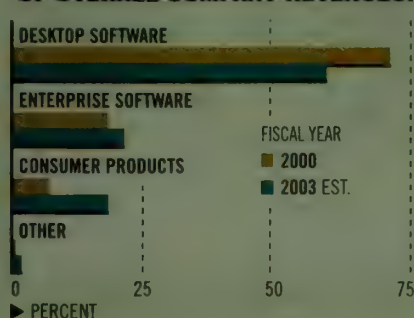
Later this year, Mira will let couch potatoes Web surf from wherever they want

DIGITAL HOME INVASION

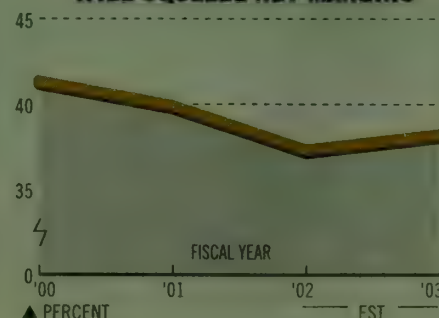
MICROSOFT'S CONSUMER REVENUES ARE EXPECTED TO SOAR...



...MAKING THEM A SIZABLE PIECE OF OVERALL COMPANY REVENUES...



...BUT THE GAME HARDWARE BUSINESS WILL SQUEEZE NET MARGINS



Data: Morgan Stanley Dean Witter & Co.

that will make it easy to connect all of its devices to one home network.

Still, no company is better fixed than Microsoft to make long-term investments in the digital home. With \$36 billion in cash, it can afford to invest heavily, experiment broadly, and wait patiently for the payoff. Microsoft's history is loaded with examples of perseverance. MSN floundered for years be-

fore Microsoft figured out how to turn it into one of the top destinations on the Web. For most of a decade, its server software was the laughingstock of corporate computing. This year, it's expected to claim 47% of the market.

So it's not surprising that Microsoft is confident it will win in the home. "A lot of this stuff isn't a question of, 'Will the dogs eat the dog food?' It's 'When?'"

says Microsoft's Mundie. Maybe so, but competitors such as Sony have thrived offering customers steak rather than chow. If Microsoft can't match Sony, it will end up on the outside of the digital home, looking in.

By Jay Greene in Seattle, with Hamm in New York, Catherine in Washington, and Irene M. Ku in Tokyo

COMMENTARY

By Cliff Edwards

COME ON, STEVE—THINK BEYOND THE MAC

When Apple Computer Inc.'s Web site proclaimed "Count the days, count the minutes, count on being blown away" in anticipation of the annual Macworld Conference & Expo that started on Jan. 7 in San Francisco, rumor had it Chief Executive Steven P. Jobs was about to announce the Next Big Thing. Industry watchers hoped Jobs would unveil a home media management center or handheld device that would help catapult Apple beyond the slow-growth desktop computing world and into dazzling new digital devices for the home.

That turned out to be wishful thinking. Instead, the highlight of Jobs's keynote was the debut of a revamped iMac. The sleek new PC offers a 15-inch flat-panel monitor connected by a swivel arm to a compact and curvy base that holds the brains of the computer. It's a beautiful design. And, in an only-too-familiar refrain, Jobs called it "the best thing we have ever done."

Steve, it's time to admit the Mac-centric strategy can only go so far. To boost its long-term prospects, Apple needs to reexamine its belief that the Macintosh will become the hub in most homes for coordinating digital devices such as cameras, music players, and handhelds. Last year, Jobs announced Apple's digital hub strategy and Apple unveiled whizzy, easy-to-use software to manage home movies and digital music. In mid-November, it brought out its card-deck-

sized iPod digital music player capable of storing 1,000 songs. Problem is, all of these products work just with Macs. Sure, 125,000 iPods were sold in six weeks. But Apple could have sold four times the number if iPod also worked with Windows machines, says UBS Warburg analyst Don M. Young.

Apple shouldn't give up on the Mac, but it could open vast new mar-

ket in a hurry. The company's worldwide market share fell to 2.9% on Oct. 1, from 3.3% a year earlier, according to market researcher IDC Corp. What's more, a slew of companies is racing to offer similar digital products for the home. Microsoft Corp. is trying to morph the PC into the hub of the digital home. And a Palo Alto (Calif.) startup called Mo-



NEW LOOKS, SAME MAC: Jobs, left, shows off the revamped iMac

kets for itself if the company applied its design prowess to other products. Mac fans have

been clamoring for an Apple handheld organizer—similar to the Palm—that works with both PCs and Macs. The company could create a sleek Apple media center that wirelessly networks any kind of computer, handheld, or other digital equipment. Or it could team up with consumer electronics companies to create Apple-branded digital gizmos with Apple's unique look and feel. So far, though, Apple hasn't signaled that it's planning on branching out beyond its Mac technology.

Apple needs to grow roots in new

Digital Inc. is working with cable and satellite providers to offer a media center that would not only control Mac and PC software but include a personal video recorder that wirelessly connects all the TVs in a home.

Apple has shown time and again that it can break the mold and make computers fun and easy to use. But that hasn't reversed its gradual slide into irrelevance. Now it needs to break out of its all-Mac, all-the-time rut. And unless it does so soon, the company's Web site might as well post this message: "Count on being underwhelmed."

Edwards covers Apple from Silicon Valley.

NICE IDEA, BUT...

The new iMac is snazzy, but Jobs's "Digital Home" concept needs more:

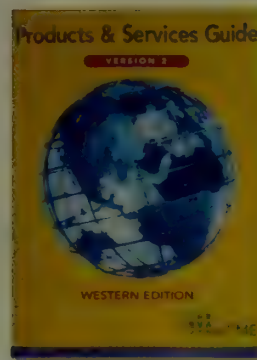
- ▶ An all-purpose media center that ties together all home digital entertainment
- ▶ An iPod digital music player that works with both Macs and PCs
- ▶ A Palm-like handheld device to remotely access a home media center

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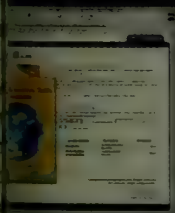


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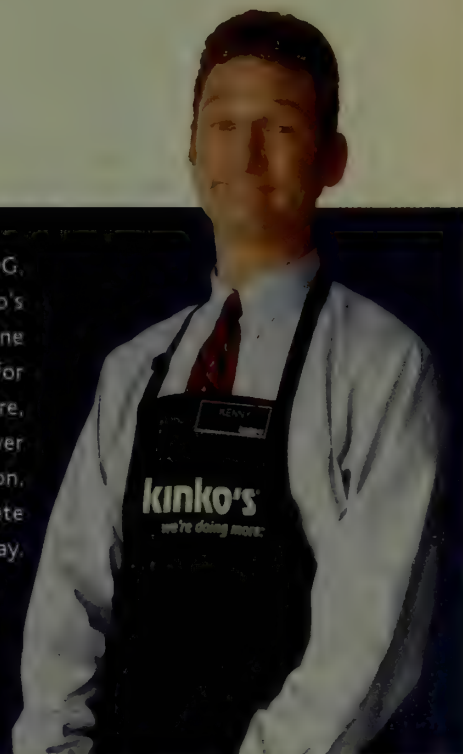
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COMMENTARY

By Catherine Arnst

JUST ANOTHER HOLLYWOOD MAD SCIENTIST

It's not easy to make science sexy. Just ask educators around the nation, whose students' science scores rank way down in international comparisons. Still, the public does have a hankering for some things scientific: Physicist Stephen Hawking's *A Brief History of Time* sold millions of copies, and his latest tome, *The Universe in a Nutshell*, has been a best-seller since November.

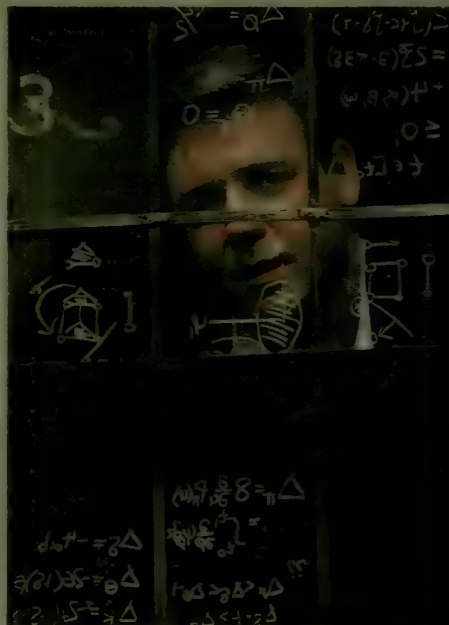
Now, Hollywood is betting that even more people will flock to a big-budget movie with a scientific background—which is why Oscar winner Russell Crowe is emoting at a cineplex near you as Nobel prize-winning mathematician John F. Nash Jr.

Crowe's new movie, *A Beautiful Mind*, follows on the heels of three plays on Broadway in the past year with scientists as their lead characters—all of them hits. *Copenhagen*, a British import that ran for 11 months, is a gripping exploration of a real-life 1941 meeting between Nobel physicists Niels Bohr and Werner Heisenberg. Both worked on atomic-bomb programs, one for the U.S. and one for the Nazis. The play is laden with challenging concepts—not least, the Heisenberg Uncertainty Principle—yet the drama is spell-binding even for viewers who never studied physics. Then there's *Proof*, which won a Pulitzer Prize in 2001 and continues to play to packed houses. It features a fictional mathematician based on John Nash. And *QED*, which will return to Broadway on Feb. 17 after a successful fall run, stars Alan Alda as iconoclastic physicist Richard Feynman, another architect of America's A-bomb.

The good news is that all this creative activity proves that science can be entertaining and popular. The bad news? The two productions that are reaching the largest audiences—*A Beautiful Mind* and *Proof*—insinuate that scientific genius goes hand-in-hand with insanity. Granted, the Mad Scientist has long been a feature of science fiction and horror flicks, but plays like *Copenhagen* and *QED* prove that science can draw an audience without resorting to such clichés.

As for Nash, both the play and

the movie get some of his story right. A brilliant mathematician in the 1950s, he suffered from paranoid schizophrenia for some 30 years. He had only recently recovered his sanity when he was awarded the 1994 Nobel prize in economics for his trailblazing work in game theory—completed when he was in his 20s. His tale was chronicled in a superbly researched 1998 biography by jour-



By falsely saying Nash was ill when he did his best work, *A Beautiful Mind* inextricably links genius and insanity

nalist Sylvia Nasar, also called *A Beautiful Mind*. But this is not the story that's on the silver screen. Director Ron Howard and screenwriter Akiva Goldsman take pains to note that their movie was "inspired by" Nasar's book, not based on it.

Indeed, Nash's story is barely recognizable in the movie version. He is still brilliant, and he still wins the Nobel. But the movie, besides throwing in lots of spy-thriller MacGuffins, implies that Nash was already

gripped by schizophrenia when he arrived at Princeton University as a graduate student in 1948. Although schizophrenia can take root years before it is diagnosed, Nash, though somewhat eccentric, exhibited no hallmarks of the disease until he was 30 and already well established as a leader in his field.

Nasar, for one, approves of Hollywood's version: "I think that if they tried to do a straight biopic, it would have been deadly." She points out that Nash's math colleagues in the movie were depicted as both brilliant and sane. True, the take-away message seems to be that Nash's greater brilliance was inextricably linked to his madness.

O.K., O.K., it's Hollywood. But *QED* shows that a Nobel genre can be both entertaining and sane. Of course, it would be hard to make Richard Feynman boring. The charismatic physicist wrote best-sellers himself and was celebrated for his wit and even his drumming (a favorite hobby) almost as much as his work in reformulating the abstruse theories known as quantum electrodynamics (the QED of the title).

Film and TV star Alan Alda commissioned *QED* because of his interest in Feynman and his own long-held love of science. "I think science is endlessly fascinating," he says, because it's about the struggle to understand. "When you think about every play by Shakespeare is about people trying to figure things out. Essentially a long monologue, *QED* illustrates well Feynman's famous sense of humor—and his beautiful mind. Like *Copenhagen*, it engages despite being loaded with ideas that many may find daunting.

A Beautiful Mind does win points for coming up with an ingenious notion to illustrate game theory. In the movie, Nash conjures up his revolutionary theory as a way to pick up girls in a bar. *Proof* that a scientist can entertain without being mad.

A Beautiful Mind does win points for coming up with an ingenious notion to illustrate game theory. In the movie, Nash conjures up his revolutionary theory as a way to pick up girls in a bar. *Proof* that a scientist can entertain without being mad.

Senior Writer Arnst covers science from New York.

ED BY OTIS PORT

10 PEAPODS T PACK INCH

MOLECULES NATURALLY together like peas in a spherical clusters of carbon atoms called buckyballs, for example, are quite common inside straw-shaped tubes, also composed of carbon. And these nanopeapods may function as smallest transistors. That's the insight revealed by intricate measurements of nano peapods by a research team led by Ali Yazdani, a University of Illinois physicist.

Using a scanning tunneling microscope, the team tracked the movement of the peapods and electron transport. The team found that changing the position of the peapods can transform the pod from a conductor to a semiconductor or insulator. As a result, in the nanochips, carbon peapods may become a versatile component that can be used to play different roles. Yazdani's team used peapods produced by David Tom, a materials science group at the University of Pennsylvania, which first created these complex structures in 1996. Since then, several peapod varieties have been produced. And in Japan, scientists have stuffed metal atoms into the pealike buckyballs. "There's a whole host of things you can put into them to modify a peapod's physical properties," says Yazdani. Studying them all will keep him busy for years. ■



OD
BUCKY-
LS

TURNING A BIONIC EYE ON RETINITIS



PATIENTS WITH RETINITIS PIGMENTOSA PROGRESSIVELY lose their sight because of the death of specialized cells, called rods and cones, at the back of the eye. Normally these cells respond to light by creating electrical impulses that the brain processes into images. Existing therapies for retinitis pigmentosa slow the deterioration of the rods and cones, but they don't arrest the disease.

Now, scientists at the University of Houston and a NASA-funded laboratory hope it may be possible to restore vision with a bionic eye. Alex Ignatiev and Dr. Charles Garcia head a team working on light-sensitive ceramic detectors that appear to function like cone cells. Hundreds of thousands of the sensors are packed together on a plastic film and implanted in the eye. Studies in rabbits indicate that the device is safe and stable, and human tests could begin in 2003. Because the signals generated by the ceramic detectors are different from those produced naturally, Garcia cautions that the artificial retina may not restore normal vision. *Ellen Licking*

BATTERY POWER: WHERE THE LATTE MEETS THE LITHIUM

IN TODAY'S MOBILE WORLD, lithium-ion batteries are the power source of choice for laptops, digital cameras, and other portable gizmos. However, these light and long-lasting batteries have a big drawback: price. They cost at least 30% more than other power packs. But Sony, which launched the first lithium-ion batteries in 1990, is working on a surprising way to cut their cost.

Here's the challenge: Lithium is a highly reactive metal and must be stabilized by encapsulating the molecules in carbon—using an expensive form of graphite derived from oil. Sony has found an alter-

native in a most unlikely place: coffee makers. In 1994, Shinichiro Yamada, a researcher in Sony's central labs, decided on a whim to see if used coffee grounds, which are largely carbon, could store lithium. Sure enough, they could.

Sony has now developed a process to harvest the carbon in coffee grounds. Although tests indicate that batteries made with coffee carbon might pack even more power than those in use today, Sony hasn't decided to go commercial yet. But if it does, the cost of carbon could be trimmed by 50%. That's because there's no shortage of the raw material in Japan, where coffee-service companies dispose of 270,000 tons of coffee grounds a year. *Irene M. Kunii*

A CUISINART FOR RECYCLING PLASTICS

RECYCLING THE MOUNTAINS of discarded computer cases, soda bottles, and other plastic waste makes ecological sense. But current recycling methods have serious flaws. Reusing a mix of different plastics typically involves a chemical glue, or "compatibilizer," to link otherwise incompatible polymers. Without good chemical bonds, the resulting material may be fragile. Yet compatibilizers "are expensive and don't always work," explains Viktor Williams, manager of global polymer recycling at DuPont in Geneva.

A new process—in essence, an industrial-scale Cuisinart—may solve these problems. Developed by Bernard Dubrulle d'Orhcel, chief technology officer of New York-based startup New Generation Plastic, the idea is to feed used plastics into a chamber with whirling blades. As the blades chop up the waste, the mechanical stress seems to break existing chemical bonds, paving the way for new ones to form, says Francesco Paolo La Mantia of Italy's University of Palermo, who has studied the process. In fact, tests show that the resulting material can have better properties than any of the original ingredients—and the process is far cheaper than current recycling methods. Says Dupont's Williams: "It is a real breakthrough." He also suggests that the technology could prove valuable in making new and better types of "virgin" plastics.

New Generation Plastic has created about 40 tons of recycled material in a French research lab using the new technique. It expects to begin building a full-scale plant in the Corrèze region of France this spring. *John Carey*

**DOLLAR-COST
AVERAGING,
HEDGE FUNDS
FOR SMALL FRY**

BusinessWeek Investor

JOSE CRUZ

Sometimes, the Best Game Plan Is the Easiest

Dollar-cost averaging lets you forget about timing the market

BY PETER COY

Over the past few years, emotion has ruled the stock market. Swept up first by greed and then by fear, investors bought high and sold low. When the market bottomed out in mid-September, many felt so burned that they hesitated to get back in—and so lost out on the 23% rise of the past four months.

Fortunately, there is one well-known investing method that eases anxiety instead of provoking it. Better yet, it naturally gets you to do the sensible thing: Buy fewer shares when prices are high and more when prices are low. It's dollar-cost averaging—the old and blessedly simple technique of putting the same amount of money into the market in regular intervals, such as every week or month. “Dollar-cost averaging is a time-tested, proven, highly reliable method to gather wealth,” says Frank Armstrong III, president of Investor Solutions in Miami.

Dollar-cost averaging is a way of life for everyone who contributes to a 401(k) plan by payroll deduction. But like any other handy tool, it can be overused. Top financial planners say that some popular notions about dollar-cost averaging don't stand up to scrutiny. For instance, many investors—and even planners—believe that dollar-cost averaging is a good way to invest lump sums. That's often not true. Investors may also believe that dollar-cost averaging immunizes them against the risks of volatile stocks. Again, not true. But it is an excellent—and underused—way to liquidate a stock portfolio or exercise a batch of stock options.

If you're dollar-cost averaging through a 401(k) or other defined-contribution plan, the smartest thing to do is very little. In other words, resist the temptation to time the market by raising or lowering your payroll contributions or by shifting your allocation back and forth among stocks, bonds, and money-market funds. The

beauty of dollar-cost averaging is that it strains you from pouring in too much when the market is near a top and you're euphoric, yet it forces you to keep contributing when the market is falling and you're tempted to get out. Luckily, people are sensible enough to stand fast. In 1999, the most recent year for which Fidelity Investments has data, there was almost no overlap between days of high stock-market volatility and days with lots of activity in 401(k) accounts.

It's equally important to know when not to use dollar-cost averaging. If you suddenly have a large sum of money to invest—an inheritance, a bonus, or a divorce settlement, for instance—you may be better off putting it all to work in the market at once. That's because stocks go up more often than they go down. So, someone who dribbles a big sum into the market a little bit at a time will tend to come out behind someone who invests the same amount right away. Says Carl Camp, president of Eclectic Associates, a financial planner in Fullerton, Calif.: “Studies indicate the stock market goes up 70% of the time. Therefore, [dollar-cost averaging a lump sum] will be wrong 70% of the time.”

Camp says he and others do advise the slow approach when they're worried about

Strategies

Dos and Don'ts of Dollar-Cost Averaging

DO

STICK WITH IT when markets tumble. Remind yourself that your dollars are buying more shares than before.

INVEST THE MOST your 401(k) plan allows.

INVEST WINDFALLS right away instead of dribbling money into the market.

DON'T

SWITCH YOUR 401(k) from stocks to bonds or a money-market fund when stocks fall.

INVEST IN VOLATILE STOCKS assuming dollar-cost averaging will give you returns without risk. It won't.

...a client would suffer from an early loss of capital. Jamie Milne, a planner in Barre, Vt., often deals with people such as recent grads who have never invested in the stock market. "I generally find that the best thing for them to do at first is nothing or at least start slowly."

Meanwhile, don't kid yourself that dollar-cost averaging will protect you from the ups and downs of the market. Armstrong, the Miami financial planner, says the strategy won't shield investors from the risk of investments that fluctuate a lot. To illustrate the point, he created a computer program with 1,000 virtual investors, each investing \$1,000 a year for 50 years in securities that produce a collective return of 10% a year.

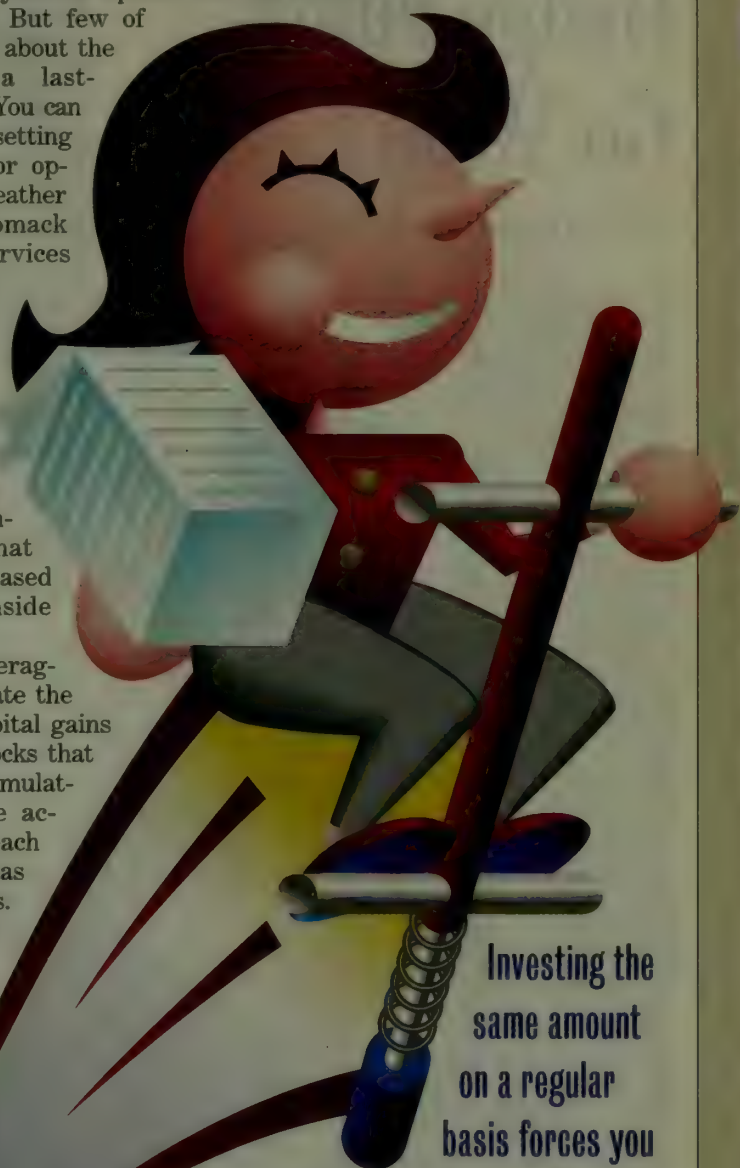
With zero volatility, each investor ends up with the same sum at the end, about \$1.3 million. If volatility is high, as it is with individual stocks, the outcomes will be widely dispersed. Let's say volatility is 30%—meaning there's only a two-thirds chance that an investor's final return will fall within 30 percentage points of the overall return of 10%. In that case, the bottom 500 of the 1,000 will earn just \$100 or less. Only 220 of them will manage to

can spare themselves the anxiety of trying to time the market by arranging to sell a certain dollar amount of shares on a regular basis. Dollar-cost averaging can also be good for exercising stock options. If risk is no concern, then the best time to exercise options is at the last possible moment, so you can squeeze out the last bit of likely upside. But few of us are that blasé about the possibility of a last-minute wipeout. You can lock in gains by setting up a schedule for options exercise. Heather Seiche of Komack Management Services in Natick, Mass., says that for top executives, an options-exercise schedule that is approved by corporate attorneys can remove the impression that they're selling based on negative inside information.

Dollar-cost averaging does complicate the calculation of capital gains when you sell stocks that you've been accumulating in a taxable account, because each small purchase has its own cost basis. Your broker will provide you with an average cost basis. Or you

can track each lot you buy, selling the ones that give you the greatest tax advantage.

In the same way that index funds are good for people who can't pick stocks, dollar-cost averaging works for people who can't time market swings. Which, come to think of it, is just about all of us.



Investing the same amount on a regular basis forces you

to be sensible: When prices are high, you buy fewer shares; when they're low, your dollars buy more

12

earn \$1.3 million (table). The average return remains \$1.3 million only because a few huge winners offset the preponderance of losers. Armstrong's imaginary example is the deck against volatile stocks unrealistically assigning them the same return as stable stocks. But the point is that dollar-cost averaging doesn't really smooth out volatility. If you're worried about the risk of owning stocks, the safer approach is to make sure you're well-diversified. If you still don't feel comfortable putting all your lump sum in the market, simply put in what you want and hold back the rest—permanently. After all, going too far is no better than going too far fast. A good and lesser-known use of dollar-cost averaging is in selling securities. People who need to liquidate portfolios—say, for retirement—

27

Imagine that 1,000 people invest \$1,000 a year for 50 years and the cumulative annual return on their investments is 10%. If their investments have zero volatility—they earn 10% every year—each investor will end up with \$1.28 million. If the investments are volatile, a few will do much better than the 10% and many more will do worse. The higher the volatility, the lower the median return—the level at which half the people do better and half do worse.

ANNUAL VOLATILITY	MEDIAN RETURN	NUMBER OF PEOPLE EARNING AT LEAST \$1.28 MILLION
0%	\$1,281,000	1,000
10%	\$1,148,000	420
20%	\$774,000	310
30%	\$413,000	220

Data: Investor Solutions Inc.

Hedge Funds Go Wide

You can buy in for \$25,000—but beware of fees



BY LEWIS
BRAHAM

Wall Street's wizards have concocted a new type of hedge fund that lets investors in for well below the standard minimum of \$500,000 or more. With investors still reeling from the ravages of the recent bear market, the sponsors of these products expect them to be popular. After all, the average hedge fund eked out a 3.2% return last year using

strategies such as short-selling and merger arbitrage, compared with the nearly 12% for the Standard & Poor's 500-stock index. Yet people need to ask themselves whether the funds are worth their high fees, especially since there are lower-cost mutual funds that can accomplish similar objectives.

These new hedge-fund products are funds of funds, which invest in other hedge funds instead of individual securities. Funds of funds have existed for more than a decade, but new ones have added a wrinkle by registering as closed-end funds under the Investment Company Act (ICA) of 1940. Registered funds

have an unlimited number of investors, so they can require minimum investments as low as \$25,000. Unregistered funds can have more than 100 investors and require high minimums to achieve any scale.

Only about 10 of these funds are currently operating, including three run by Montgomery Asset Management and two by Oppenheimer Funds. Most were launched in 2001 (table). Many more are scheduled to open this year. "Hedge funds are becoming mainstream," says Charles Graham, chief investment officer of Henry Hedge Fund Advisory Group. In some cases, some of these new funds—by also registering under the Securities Act of 1933—will have the ability to advertise to the public. Traditional hedge funds cannot do that.

The potential market for these funds is huge. By law, hedge funds can only accept "accredited investors" who have at least \$1 million in assets, but plenty of people who qualify still can't afford to plunk half of their assets into a single fund. According to a study by Montgomery Asset Management, 90% of millionaire households have assets in the \$1 million to \$5 million range. The million-dollar households are the primary targets for funds such as Montgomery's Absolute Return and Oppenheimer's Tremont Market Neutral Fund.

Still, the lower-minimum funds are not bargains. Montgomery's is typical, charging an annual management fee of 1% of assets plus an incentive fee equal to 30% of investment profits. That's in addition to the fees levied by the underlying hedge funds, which usually take 1% of assets plus 20% of profits. The total: 2% plus 30% of

profits—compared with a flat 1.5% annually for a large-cap equity fund. Roughly speaking, that means if a fund of hedge funds has a gross return of 20%, the net after fees would be just 19.2%. A mutual-fund investment would net 28.1%. In addition, the brokers' sales charge, or load, typically amounts to as much as 5% off the top. So your odds of beating a no-load mutual fund after fees are slim.

Charges on these new hedge-fund products can be steep and can eat into returns



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that the bear
market's worst
may be over,
hedge funds are
likely not
a good investment.
Over the long term,
they have trailed
the S&P 500

To be fair, the purpose of funds of hedge funds is to deliver returns in both down and up markets, not to trump mutual funds or a stock index. In that regard, they have succeeded in recent years, with the average fund of hedge funds delivering a net 31.9% three-year cumulative return vs. the S&P 500's 1.7%. But now that the recent bear market's worst days appear to be over, these funds are probably not a good investment. Over the long term they have lagged the S&P 500.

Investors looking to hedge their portfolios can find cheaper alternatives in retail mutual funds. Merger Fund, which has a \$2,000 minimum investment, is up 44.2% cumulatively over the past three years, besting the average fund of funds. It uses the same low-risk merger-arbitrage strategy as many hedge funds for a fraction of the cost—a flat 1.34% of assets. The list of successful long-short funds, such as Calamos Market Neutral and Boston Partners Long-Short Equity, is growing (BW—Dec. 31). Such funds have profited handsomely in bear markets, and by allowing daily redemptions, they offer greater liquidity than hedge funds, which usually permit investors to cash out only quarterly or semi-annually.

Technically, some of the new hedge fund products don't have to put any net worth

Low Minimums, High Fees

FUND OF FUNDS	INVESTMENT MINIMUM	FEES**
AXA NEW HORIZONS FUND*	\$50,000	2.50% + 2% load
DB ABSOLUTE RETURN FUND*	\$50,000	1.95% + 2% load
GAM AVALON MULTI-GLOBAL	\$50,000	2.00% + 5% load
MONTGOMERY PARTNERS ABSOLUTE RETURN*	\$25,000	1.00% + 10% of profits + load***
OPPENHEIMER TREMONT MARKET NEUTRAL	\$25,000	2.15% + 5% of profits + 2.5% load
WHISTLER FUND	\$150,000	1.00% + 10% of profits + 3% load

*In registration **Fund of fund fees only; does not include management and incentive fees of the hedge funds in which they invest ***Sales load not disclosed

Data: Fund prospectuses

requirements on investors. By registering with the Securities Act of 1933, funds such as Oppenheimer Tremont Market Neutral have become public securities instead of private hedge funds, eliminating the need for accredited investors. "If you register under the 1933 Act, you can sell your fund to anybody you want," says Barry Barbash, a former director of the Securities & Exchange Commission. That's not happening yet, though. Tremont Advisers has set a net worth minimum of \$1.5 million because of a rule forbidding funds from charging incentive fees to investors with less than that amount. Tremont Advisers declined to comment.

Maybe one day, if fees come down, funds of hedge funds will be worth considering for their diversification benefits. But right now, investors must pay too much for too little in return. ■

Dollars-and-Cents Guide to the Euro

new currency brings many benefits to Americans

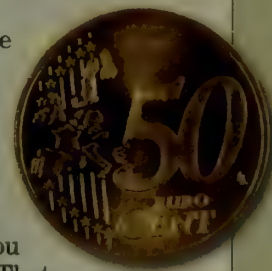
On Jan. 1, Germany, France, and 10 other European Union nations finally introduced the universal currency that would replace their national monies. "This is a great day for Europe and Europeans," exulted European Commission President Romano Prodi as church bells ushered in the New Year and the first euro notes started pouring out of ATMs.

But what does this massive change-over mean for Americans? Mainly good things, judging by the reports so far. The biggest benefit: Instead of keeping track of different exchange rates and

various sizes and shapes of notes and coins, travelers can now use the same money from the south of Portugal to the north of Finland. And they'll pay just one commission when converting dollars into euros. "It's certainly making life easier for me," said Marion Schneider, a

Philadelphia schoolteacher who was touring Germany, Belgium, and France. "I changed my dollars in Frankfurt and can use the euro I got everywhere."

The euro also makes it more economical for travelers who opt to withdraw cash from European ATMs. Because you don't have to worry about re-converting leftover currencies, you can take out a large amount in the first country you visit to use your entire trip. That way, you make fewer withdrawals and pay fewer fees. So a tourist planning to spend two days in France, two in Italy, and two in Spain need only use the cash dispenser once instead of three times. Schneider figured she saved at least \$20 in commissions—"enough for a nice bottle of



DAVID
AMB

Don't worry if you have money left from your last trip to Europe. You have until Feb. 28 before old currencies disappear from use in most nations

wine," she said.

With the euro, Americans will find that it's now easier to compare prices. Since the euro is currently worth about 90¢, it's close in value to the dollar. It may even reach parity early in 2003 as it's expected to strengthen by up to 10% against the greenback later this year. In any case, a 40,000 Italian lire lunch bill is a lot less daunting when it's expressed as 20.65 euro (\$18.60). "It's a lot easier thinking in euro," said Astrid Smith, a New York insurance worker on a winter holiday in Europe. "I see the price, take off about 10%, and then I have the dollar equivalent."

To make things even more convenient, the euro is likely to be accepted in European countries that are retaining their currencies. Major British department stores, such as Harrods and Marks & Spencer, are happy to accept the new money. So are many tourist establishments in Switzerland, another favorite destination of American travelers. And don't forget: The euro is now the official currency on the islands of Guadeloupe, Martinique, St. Barts, and St. Martin, as well as the Vatican, Andorra, and a number of other regions around the world. So if you have some

euros left from your summer holiday in Europe, you can use them on your winter getaway to the Caribbean.

You needn't worry if you have old currency left in your wallet from your last trip to Europe. You have until Feb. 28 before legacy currencies will disappear from general use in most countries. Until then, you can pay old currencies at banks or convert them into dollars at U.S. currency exchange bureaus. European central banks, meanwhile, will accept them long after Feb. 28 in most euro zone countries, and when they stop, national central banks will exchange them for years after that (table).

You can also give your leftover European currencies and coins to charity. The Giant Food Store, which has more than 100 stores from Virginia to

New Jersey, has launched a "Euro Is Coming" campaign. The Washington Post and Chase Bank. Just drop change into collection boxes at Giant supermarkets. The company will convert them into dollars and donate the proceeds to the Capital Area Food Bank, which distributes food to the needy in and around Washington.

Don't bother hoarding old notes and coins in the hope they will be collected as items one day. European central banks anticipate that up to 5% of the legacy currencies will never be converted into euros, and too much of the money still

floating around to generate interest from serious collectors. Far wiser to spend or donate any old currency you're holding.

With Christine
in France

Out with the Old

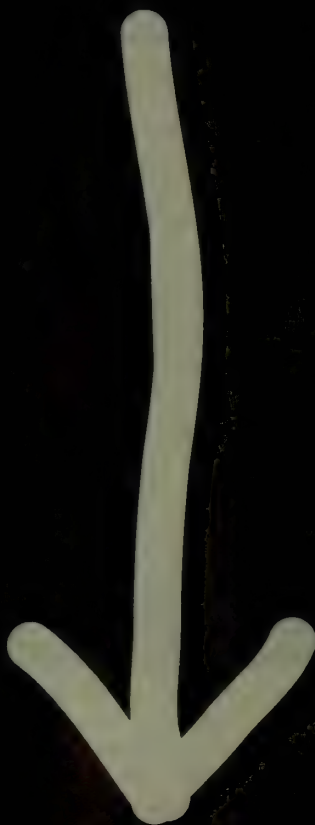
	ONE EURO COSTS	END OF LEGAL TENDER OF LEGACY CURRENCY	LAST DAY COMMERCIAL BANKS WILL EXCHANGE LEGACY CURRENCY	TIME PERIOD THAT CENTRAL BANKS WILL EXCHANGE LEGACY CURRENCY NOTES
AUSTRIA	13.7603 schillings	Feb. 28, 2002	Up to individual bank	Unlimited
BELGIUM	40.3399 francs	Feb. 28, 2002	Dec. 31, 2002	Unlimited
FINLAND	5.94573 markkas	Feb. 28, 2002	Up to individual bank	10 years
FRANCE	6.55957 francs	Feb. 17, 2002	June 30, 2002	10 years
GERMANY	1.95583 marks	Dec. 31, 2001	Feb. 28, 2002	Unlimited
GREECE	340.75 drachmas	Feb. 28, 2002	Up to individual bank	10 years
IRELAND	0.787564 pounds	Feb. 9, 2002	Up to individual bank	Unlimited
ITALY	1936.27 lira	Feb. 28, 2002	Under consideration	10 years
LUXEMBOURG	40.3399 francs	Feb. 28, 2002	June 30, 2002	Unlimited
NETHERLANDS	2.20371 guilders	Jan. 27, 2002	Dec. 31, 2002	30 years
PORTUGAL	200.483 escudos	Feb. 28, 2002	June 30, 2002	20 years
SPAIN	166.386 pesetas	Feb. 28, 2002	June 30, 2002	Unlimited

Data: Various central banks



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A BALANCING ACT FOR GEN X WOMEN



BY TODDI GUTNER

hers@businessweek.com

Many baby boomers focused solely on work in order to succeed; younger women want more time with family

Jill Nelson, 33 and single, has a different attitude toward her job than a woman a generation older might have had. An institutional sales representative for Pfizer, Nelson looks forward to a long career with the pharmaceutical company. But unlike many baby boomer women who felt they had to make big personal sacrifices to achieve success, Nelson is more interested in a well-rounded life. "Do I want to be CEO of Pfizer? No," she says. "But I do want a stimulating position that will let me balance my work and my family."

Nelson's views are reflected in a recent study of Generation Xers by Catalyst, a New York group that seeks to advance women in business. The research began in 2000, but was updated after September 11. Of the 1,300 professionals aged 26 to 37 who responded, 70% were women. The study found that Gen Xers are neither slackers nor frenetic job hoppers, but traditionalists at heart. "It's a generation that values company loyalty and wants work-life balance," says Catalyst President Sheila Wellington.

In fact, nearly half of the young professionals surveyed would be content to spend the rest of their careers with their current companies. In addition, over 70% rated companionship, a loving family, and enjoying life as extremely important. By contrast, less than 20% said earning a lot of money and becoming an influential leader were extremely important goals (table).

Many of their predecessors—myself included—who came of age in the 1970s and 1980s defined success as rising through the ranks and, ultimately, landing the top job. "They had one chance at the brass ring, and they didn't believe they could jump off and then get back on," says Myra Hart, a professor at Harvard Business School. "To them, it was a distinct choice."

That choice came at a high price. Another recent Catalyst study showed that only 67% of top executive women with MBAs were likely to be married, compared with 84% of men with the same work success. When it comes to children, nearly 75% of the men have kids, while only 49% of the women do. These women "had to go singlemindedly to get into the game and couldn't have gotten ahead unless they let everything go," says Nancy Evans, editor-in-chief at iVillage.com. "They felt re-



HOME FIRES:

Pfizer's Nelson is looking for a well-rounded life

sponsible to succeed on behalf of all women." When I was single, I was working night weekends to build a career. I took a husband and two pro-

blems to make me realize, at 40, that I had to find a better balance of work and personal satisfaction. I did it by reducing my work hours, taking a salary cut, and dialing back my ambition.

The baby boomer women who have advanced to senior positions in their fields made a strong impression on Gen X women—but it wasn't always positive. "The sacrifices those women made were transparent. The younger women can see the toll it has taken, and they're opting for a different path," because the rewards don't seem worth it, says Mary Lou Quinlan, head of Just a Woman, a marketing company that helps companies better understand female customers.

Rather than landing the top job, women in their 20s and 30s want to have more control over their lives. That means different choices than different people, but popular options include starting businesses or working for companies that offer flexible hours.

That's certainly the case for Carolyn Regan, 31, a human resources manager at public relations firm Weber Shandwick Worldwide in Boston. "I was holding myself up to how men see me as successful, using external factors like title and money," says Regan, a mother who recently reduced her workweek to three days. "I love my career, but there are other things in life I want to take advantage of."

No doubt there will be an economic and social price to pay for women who pare their work hours and career goals. But for them, satisfaction comes in answering to their own values rather than Corporate America's expectations.

The New Traditionalists

The following shows what percentage of Generation Xers rated various values and goals as being extremely important to them

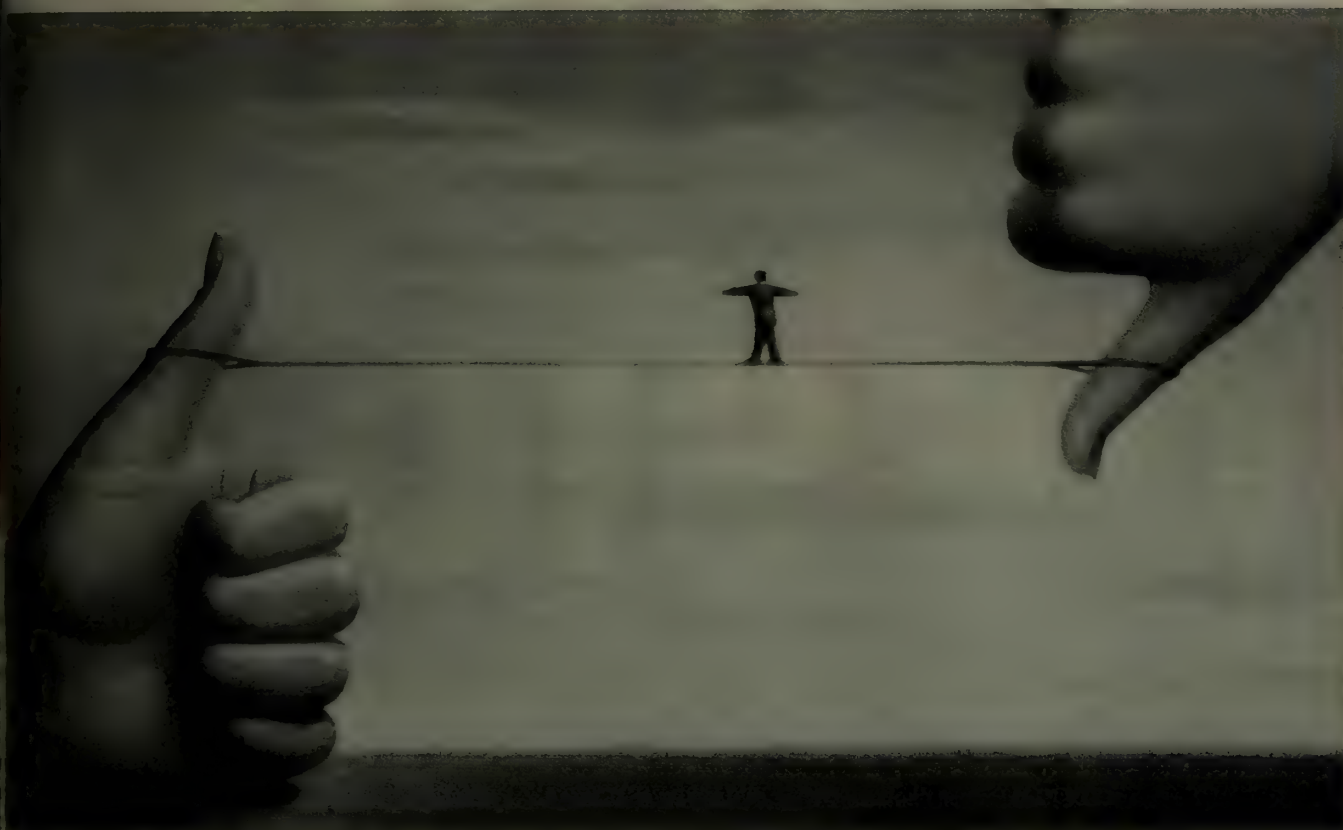
To have a loving family	84%
To enjoy life	79
To obtain and share companionship with family and friends	72
To establish a relationship with a significant other	72
To have a variety of responsibilities	22
To earn a great deal of money	21
To become an influential leader	16
To become well-known	6

Data: Catalyst

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AOL: STILL FANTASY STOCK



ROBERT BARKER
businessweek.com

Current levels,
media giant
looking
investors
see a bargain
giving
the
its

AOL Time Warner's new hit movie *Lord of the Rings: The Fellowship of the Ring* presents a strange, fantastical world. It's lit one moment by fireworks; the next, smoke and mist obscure every vista. This atmosphere, at once intriguing and spooky, turns out to be very much like what awaits anyone who dares to tour AOL's financial world, a land full of skyrocketing cash flows and unfathomable write-offs. You can read AOL's financial statements, as I have recently, and come away with as clear a view of reality as you would get by following Frodo Baggins through Middle Earth.

This is a pity, because shares in AOL, trading recently near \$32, probably look tempting to many investors. I warned against them a year ago after AOL completed its deal for Time Warner amid enough hype to make a Hollywood publicist blush. But they're a lot cheaper today, down from a peak in May of more than \$58. As they kept falling, I began to wonder: Are they a bargain?

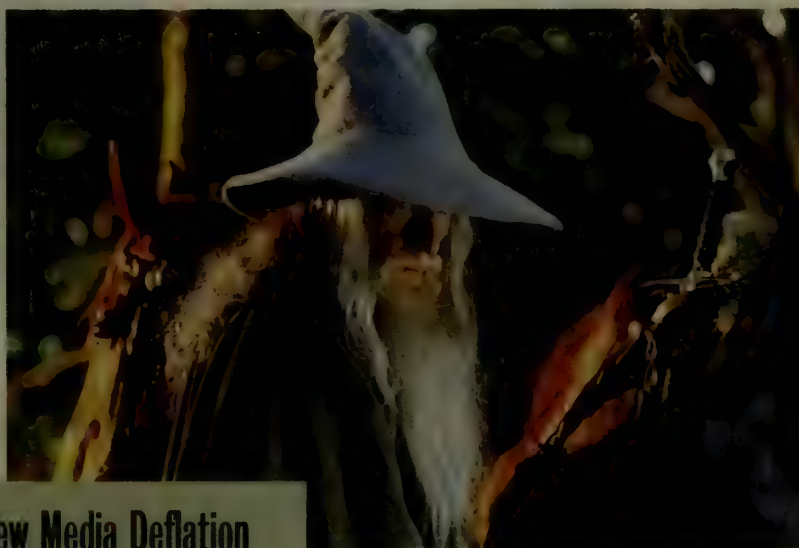
Don't bet on it. It's not the litany of recent AOL worries, from sluggish advertising sales to slower growth in online subscribers to the untimely decampment of CEO Gerald Levin, that leaves me skeptical. It's not even the \$40 billion to \$60 billion asset write-down AOL is taking to concede how wildly overpriced its merger with Time Warner proved. On the contrary, these concerns seem to have been duly noted by investors as AOL shares edged their way down. What stumps me about AOL is the proposition that there's some magic in this media monolith that should compel investors to take on the risk implied by its premium price.

To CEO-in-waiting Richard Parsons, a rich market valuation makes sense given the company's strategic position. "AOL Time Warner is the most exciting company in the world," he told Wall Street in a Jan. 7 presentation, with "the potential to be the most valuable." One day, maybe. Today, though, it's worth wondering if AOL deserves a market value of \$146 billion, No. 16 on planet Earth, just behind Cisco Systems.

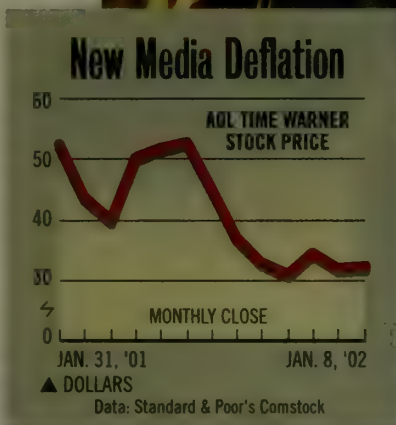
A clearer picture will emerge Jan. 30, when

the company is set to release detailed results for 2001. AOL already has indicated that the year brought 5% growth in revenue, to \$38 billion. "EBITDA"—earnings before interest, taxes, depreciation and amortization, a measure that AOL and other media companies focus investors on—grew 18%, to nearly \$10 billion. Amid recession and slumping ad sales, that's healthy. Yet that also implies a price-to-EBITDA multiple of 15, when AOL itself sees EBITDA growth slowing this year to 8% to 12%. Next to shares of rival Walt Disney, trading recently at an EBITDA multiple below 10, AOL stock hardly screams "Buy me!"

AOL measures success internally not just by EBITDA but also by "free cash flow"—cash from operations after capital spending and dividends. In 2001, not counting a raft of items it considers unusual, the company estimates free cash flow hit \$3 billion. That means the market is valuing AOL shares at 49 times free cash flow.



REEL LIFE: *The Rings* film is a hit



To see how that compares, I searched Morningstar's database for companies with positive free cash flows over the most recent 12 months and market values of at least \$100 billion. Various accounting treatments can make this a bit hazardous. Yet it is also instructive. Besides AOL, I found 21 others, from market-cap leader General Electric down to Philip Morris. Only four—Intel, Vodafone, Wal-Mart, and SBC Communications—were trading at multiples of free cash flow higher than AOL's. Many big growth stocks, including Microsoft (29) and Merck (24), were going a lot cheaper.

In the *Rings* movie, a world-weary hobbit at one point complains: "I'm feeling like butter, scraped over too much bread." If AOL shares tempt you, just substitute free cash flow for butter and the stock's price for bread. ■

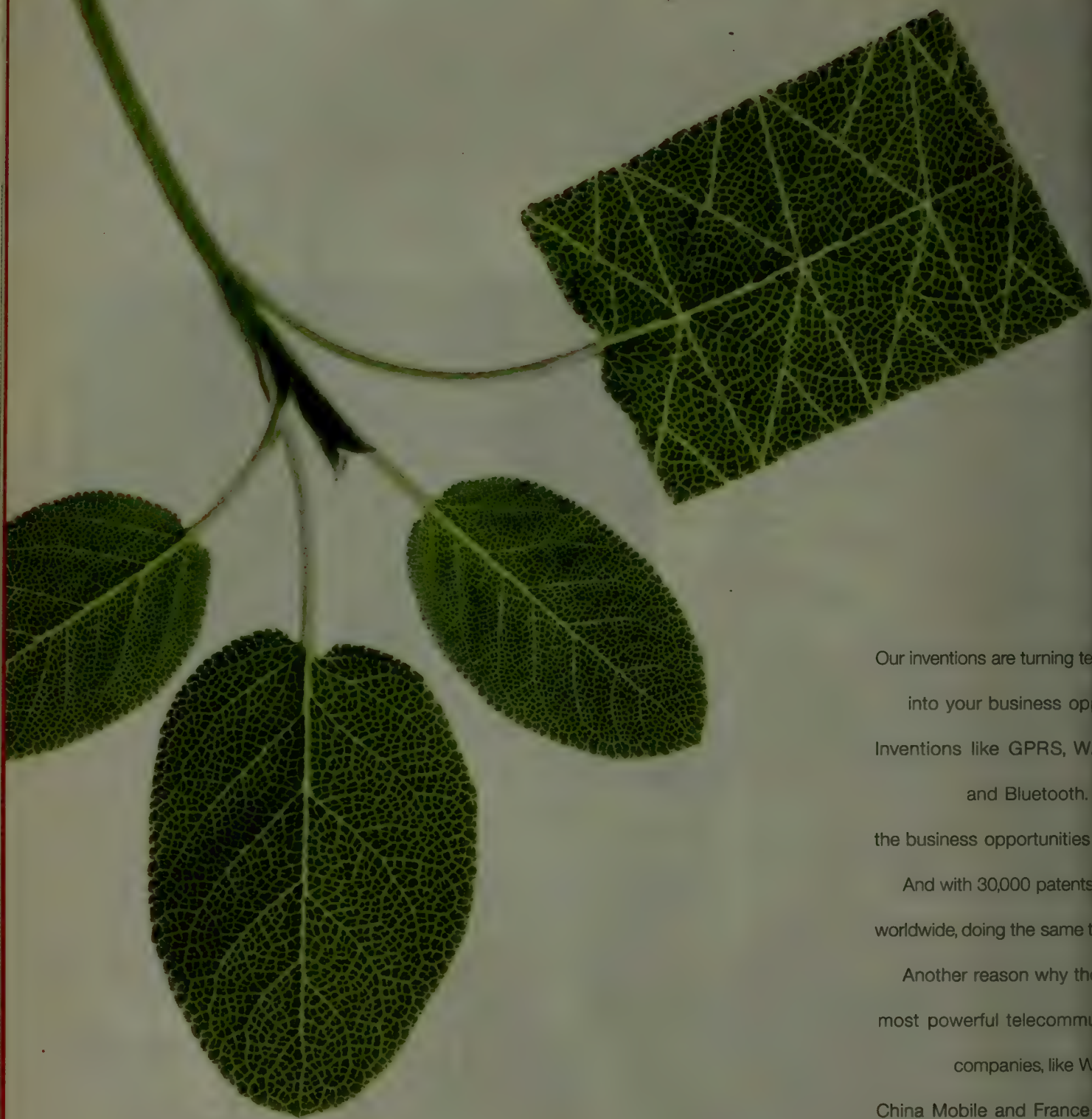
BusinessWeek online

For more on AOL Time Warner's huge write-off, go to barker.online at www.businessweek.com/investor/ and click on "Columns"

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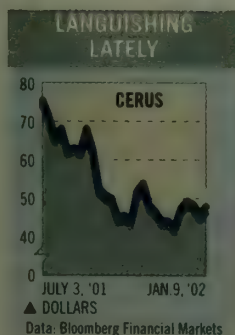
In the wake of last year's tech cave-in, shares of EMC (EMC), the world's No. 1 provider of data-storage hardware and software, plunged from 80 in mid-January, 2001, to 10 on Sept. 21. Since then, the stock has rallied to 17—thanks to some analysts who think EMC has hit bottom. But at least one money pro is buying EMC for another reason: Hilary Kramer, senior managing director at Cisneros Group, a private outfit that manages billions, has snapped up shares—because she believes EMC is takeover prey. She expects IBM will ultimately buy EMC, whose market share is under siege, in part because IBM has made a forceful foray into the business.

IBM is engaged in a fierce price battle with EMC to gain market share in the \$35 billion storage business, says Kramer. In the third quarter, IBM expanded its storage business by more than 20%, and EMC's revenues shrank by nearly 50%. It wasn't that IBM's storage product, Shark, was superior. Rather, IBM was "gift-wrapping Shark," and was almost giving Shark away by bundling it with server-storage-services deals—and hurting margins, says Kramer. She says IBM will be willing to pay a premium for EMC to dominate a sector that could produce 60% profit margins to a company that provides the full range of data-storage software, hardware, and services. If it buys EMC, IBM will acquire EMC's high-end, industry-trusted products, which would advance IBM's goal of one-stop shopping, says Kramer.

Even without a takeover, EMC is worth 20 a share, based on six times the company's 2003 revenues, says Clinton Vaughan, an analyst at Salomon Smith Barney. EMC and IBM declined comment.

CERUS MAY GET IN BAXTER'S BLOOD

At the height of 2001's brief but intense biotech fever, Cerus (CERS) was a highflier, soaring from 33 in April to 75 on July 3. Since then, the stock has given up much of its gain, languishing at around 47 since late September. Yet the goings-on at Cerus could send the stock up again. Cerus develops products that make blood transfusions much safer by preventing viruses and bacteria from replicating in the blood. Cerus' lead product is Intercept Blood Systems, which inactivates blood-borne pathogens in transfusion products. Clinical trials in the U.S. and Europe have produced favor-



KRAMER: EMC is takeover bait

able results. Cerus presented data on all three of its primary pathogen-inactivation systems—platelets, plasma, and red blood cells—in December at a conference of the American Society of Hematology.

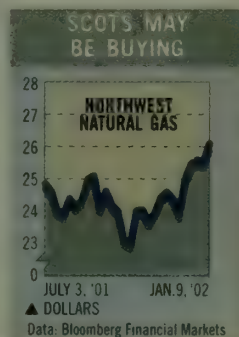
Some fund managers believe approval in Europe for Intercept platelets will come earlier than the Street expects—sometime in the first quarter of 2002. Katherine Martinelli of Merrill Lynch says that if such approval comes through, Cerus should be able to market the product in the second half of this year. Cerus also has filed for Food & Drug Administration approval in the U.S.—and clearance is expected in late 2002. This is a big deal for Cerus, whose partner in developing and marketing Intercept is Baxter International, with a 17% stake in Cerus.

Buyouts have been plentiful in the biotech sector, and there is speculation that Baxter may ultimately acquire Cerus. That's very possible, says Martinelli, who thinks Baxter may wait to see how fast sales ramp up. Baxter is obliged to pay 30%-to-50% royalty on Cerus' products under its partnership agreement in what could be a multi-billion dollar market. So Baxter might just opt to buy Cerus rather than pay the big royalty. Martinelli rates Cerus a strong buy, with a 12-month price target of 75. Baxter declined comment. Cerus CEO Stephen Isaacs says there aren't any discussions with Baxter to date about a buyout.

UPPING THE PRESSURE AT NORTHWEST

You might expect the stock of Northwest Natural Gas (NWN) not to be rising just now. It is seeking to purchase beleaguered Enron's Portland General Electric, valued at \$2.8 billion. True, Northwest, a fast-growing company serving Oregon and parts of Washington, expects to save \$30 million a year in efficiencies from the deal. But usually the stock of a buyer comes under pressure. Instead, the stock has risen, from 22 in October to 26.15 on Jan. 9.

One reason: Northwest is seen by smart-money pros as buyout bait itself. Some industry people think that a potential suitor is Scottish Power, a Glasgow energy group engaged in natural-gas distribution in Britain. These sources say that Scottish has been eyeing both Portland General Electric and Northwest. It may get its hands on Portland, these pros say, by acquiring Northwest—after it has bought Portland.



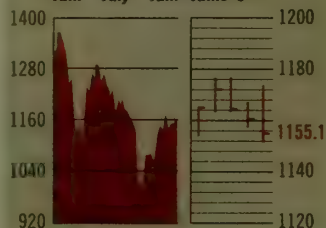
BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn's *The Money Gang*.

Stocks

S&P 500

Jan. July Jan. Jan.3-9



COMMENTARY

The markets sank abruptly on Jan. 9, after spending most of the day in positive territory. Better-than-expected sales by SAP sparked the surge, but stocks then fizzled as investors worried that the rally that began in the aftermath of September 11 might not be sustained. For the week, Nasdaq rose 3.3%, while the Dow Jones industrial average and S&P 500 index were flat.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Jan. 9	Week	Year to date	Last 12 months
S&P 500	1155.1	0.0	0.6	-11.2
Dow Jones Industrials	10,094.1	0.2	0.7	-4.5
Nasdaq Composite	2044.9	3.3	4.8	-16.2
S&P MidCap 400	512.9	1.3	0.9	5.1
S&P SmallCap 600	235.3	1.6	1.3	11.9
Wilshire 5000	10,782.4	0.3	0.7	-9.4

SECTORS

	Jan. 9	Week	Year to date	Last 12 months
BusinessWeek 50*	740.6	0.7	1.5	-23.7
BusinessWeek Info Tech 100**	431.6	1.5	2.9	-26.3
S&P/BARRA Growth	599.2	-0.1	0.8	-10.5
S&P/BARRA Value	554.6	0.2	0.5	-12.5
S&P Energy	818.4	1.4	0.0	-8.0
S&P Financials	147.4	1.1	0.0	-6.8
S&P REIT	93.5	0.1	0.1	7.1
S&P Industrials	260.6	-2.1	-1.9	-4.9
S&P Utilities	236.6	2.9	0.0	-8.0
GSTI Internet	110.5	4.8	5.3	-36.8
PSE Technology	719.2	3.4	4.6	-11.4

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

Group	Last month %	Last 12 months %
Health-Care Supplies	16.9	57.7
Internet Software & Svcs.	14.6	52.5
Computer Stores	12.5	45.9
Air Freight & Couriers	11.2	45.1
Office Electronics	11.1	45.0

GLOBAL MARKETS

	Jan. 9	Week
S&P Euro Plus (U.S. Dollar)	1069.7	-1.4
London (FT-SE 100)	5228.5	0.2
Paris (CAC 40)	4587.0	0.1
Frankfurt (DAX)	5288.2	2.3
Tokyo (NIKKEI 225)	10,664.0	2.0
Hong Kong (Hang Seng)	11,440.7	0.8
Toronto (TSE 300)	7775.8	1.7
Mexico City (IPC)	6550.6	2.3

FUNDAMENTALS

	Jan. 8	Week
S&P 500 Dividend Yield	1.33%	
S&P 500 P/E Ratio (Trailing 12 mos.)	48.9	
S&P 500 P/E Ratio (Next 12 mos.)*	22.1	
First Call Earnings Surprise*	8.19%	

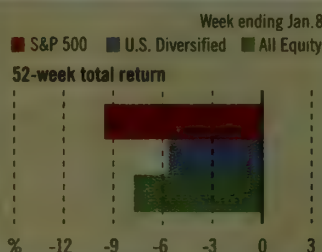
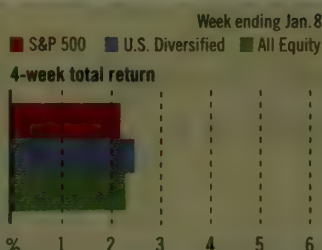
TECHNICAL INDICATORS

	Jan. 8	Week
S&P 500 200-day average	1166.7	1166.7
Stocks above 200-day average	61.0%	
Options: Put/call ratio	0.67	
Insiders: Vickers Sell/buy ratio	2.45	

WORST-PERFORMING GROUPS

Group	Last month %	Last 12 months %
Wireless Services	-15.4	-15.4
Food Chains	-12.3	-12.3
Agricultural Products	-11.7	-11.7
Photographic Products	-10.9	-10.9
Telecomms. Equip.	-10.5	-10.5

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

Category	4-week total return %	52-week total return %
Leaders		
Precious Metals	6.7	25.5
Diversified Emerging Mkts.	6.7	18.7
Latin America	5.6	11.3
Pacific/Asia ex-Japan	5.3	9.3
Laggards		
Japan	-2.3	-34.4
Health	-1.0	-29.2
Communications	0.9	-26.7
International Hybrid	1.1	-20.1

EQUITY FUNDS

Fund	4-week total return %	52-week total return %
Leaders		
Frontier Equity	16.3	91.0
Pilgrim Russia A	15.5	76.0
Van Eck Troika Dialog A	11.5	65.3
Matthews Korea	11.1	56.9
Laggards		
TCW Galileo Opportunity N	-38.1	-65.4
TCW Galileo Incm. & Gr. N	-23.6	-65.4
World GenomicsFund.com	-10.4	-64.8
Reg. Opport. Ohio-Ind.-Ky. B	-6.6	-62.8

Interest Rates

KEY RATES

	Jan. 9	Week
MONEY MARKET FUNDS	1.76%	1.8
90-DAY TREASURY BILLS	1.66	1.7
2-YEAR TREASURY NOTES	2.98	3.2
10-YEAR TREASURY NOTES	5.04	5.1
30-YEAR TREASURY BONDS	5.49	5.5
30-YEAR FIXED MORTGAGE	7.21	7.2

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.48%
TAXABLE EQUIVALENT	6.45
INSURED REVENUE BONDS	4.67
TAXABLE EQUIVALENT	6.77

THE WEEK AHEAD

RETAIL SALES Tuesday, Jan. 15, 8:30 a.m. EST ► Retail sales likely dropped 1.2% in December. That's based on the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies. Sales excluding autos probably posted a 0.1% gain.

CONSUMER PRICE INDEX Wednesday, Jan. 16, 8:30 a.m. EST ► Consumer prices for goods and services were likely unchanged in December. Excluding food and energy, core prices probably increased 0.2%.

BUSINESS INVENTORIES Wednesday, Jan. 16, 8:30 a.m. EST ► Inventories in November are projected to have fallen 0.2%, after tumbling 1.4% in October.

INDUSTRIAL PRODUCTION Wednesday, Jan. 16, 9:15 a.m. EST ► Factory output in December probably held steady, while the capacity utilization rate likely slipped to 74.6%, from 74.7% in November.

BEIGE BOOK Wednesday, Jan. 16, 2 p.m. EST ► The Federal Reserve Bank will re-

lease its report on regional economic activity in advance of the policy scheduled for Jan. 29-30.

NEW RESIDENTIAL CONSTRUCTION Jan. 17, 8:30 a.m. EST ► Housing in December are forecast to have risen 3%, to an annual rate of 1.6 million units.

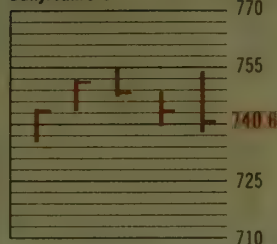
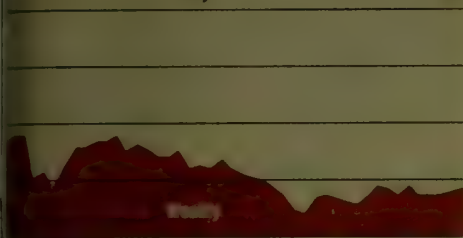
INTERNATIONAL TRADE Friday, Jan. 18, 8:30 a.m. EST ► The trade deficit probably widened to \$30 billion in November, from \$29.4 billion in October.

BusinessWeek Fifty

July

Jan.

Daily: Jan. 3-9



0.7% for the week, led by technology. Oracle, the software giant, propelled the group, rising 17.5% and 17.4%, respectively. Applied Materials, semiconductor equipment maker, also climbed 12.0% and is up 3% since March, 2001, when the 50 were chosen. Brokerage stocks were strong, with Merrill Lynch up 11.5%.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
National	-5.3	-0.7	26	Verizon Communications	0.8	0.9
Petroleum	-4.2	-16.9	27	Citigroup	-2.4	2.3
	-6.5	-64.7	28	Sun Microsystems	4.1	-32.3
	-0.4	-44.6	29	Merck	-1.6	-26.2
Materials	12.0	3.0	30	El Paso	-4.4	-38.5
Financial	1.4	-92.7	31	Altera	13.0	-0.3
Petroleum	-1.7	9.1	32	Marsh & McLennan	-4.1	-2.9
	-1.4	-9.5	33	Household International	0.0	-2.2
	-0.1	-16.4	34	ChevronTexaco	-0.4	2.6
	19.7	-21.7	35	SBC Communications	-4.3	-16.1
Others Holdings	4.8	-0.2	36	Mercury Interactive	5.4	-38.6
	17.4	-59.5	37	AOL Time Warner	-0.2	-28.3
	3.0	-68.3	38	Washington Mutual	6.3	2.4
Laboratories	-1.1	17.6	39	General Dynamics	1.2	20.7
Financial	-3.1	-15.1	40	Comcast	1.8	-15.6
Technology	5.3	-2.5	41	Morgan Stanley Dean Witter	5.7	-8.2
	7.2	7.3	42	Tellabs	6.0	-60.9
Energy	-1.7	-15.6	43	Exxon Mobil	-0.9	-3.6
	-2.7	-6.4	44	Scientific-Atlanta	6.6	-42.1
Communications	17.5	-50.3	45	U.S. Bancorp	0.9	-10.8
Financial	2.0	-2.9	46	Paychex	2.3	-10.3
Petroleum	-1.9	10.3	47	Merrill Lynch	11.5	-3.3
Utilities	4.4	14.9	48	Bed Bath & Beyond	0.5	33.9
Resources	-1.5	-14.1	49	Texas Instruments	-2.1	-12.9
Health	-3.8	-7.7	50	Teradyne	12.7	11.8

Production Index

Change from last week: 0.4%
Change from last year: -11.1%

INDUSTRIAL OUTPUT Dec. 29=158.5 1992=100



This is a 4-week moving average

The index rose over the latest week. Because of the four-week moving average, the index is 160.5, from 159.0. After seasonal adjustment and crude-oil refining led the index higher, power and rail-freight traffic also posted gains. Production fell sharply, while coal and truck plants were closed for the remainder of the seasonal holidays. The index dropped to 158.4, from 159.9 in November. For more information on the index components is at www.businessweek.com.
Production index Copyright 2002 by The McGraw-Hill

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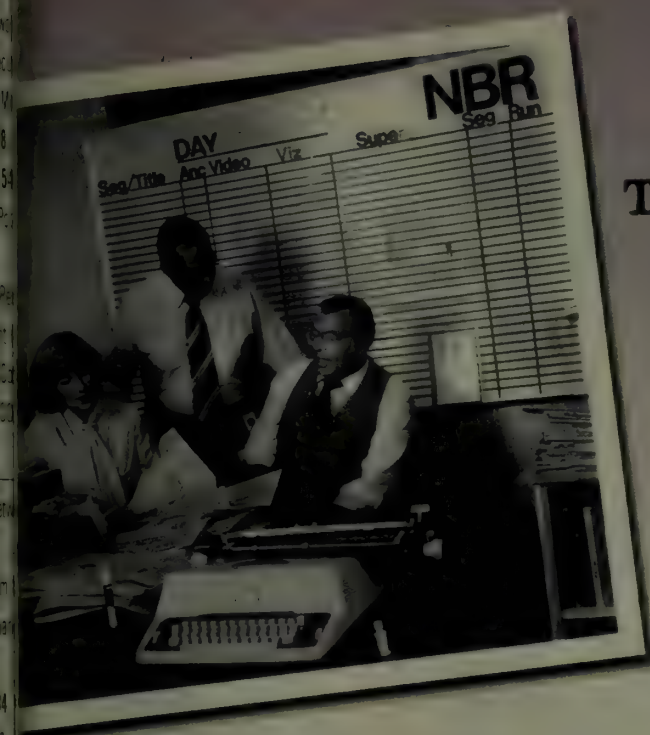
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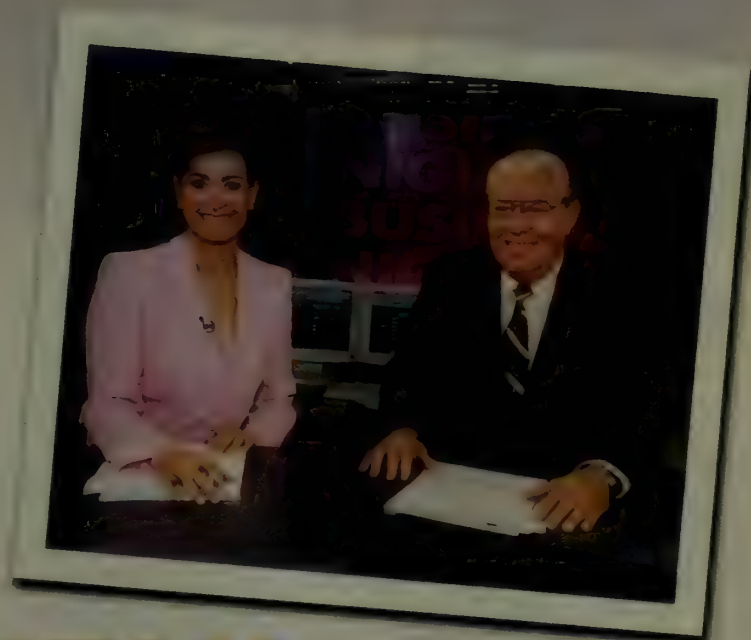
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THE RETURN OF POLITICS AS USUAL

Alas, the political season is upon us. The bipartisan bonhomie of the post-September 11 period is gone, at least when it comes to domestic issues. With congressional elections only 10 months away, fierce political arguments are breaking out in Washington that have little to do with economic and fiscal reality. It may be wise to take a moment to analyze the accusations and penetrate the posturing.

Democrat Tom Daschle, the Senate majority leader, started it off by accusing President George W. Bush of making the recession worse with his \$1.35 billion, 10-year tax cut that killed the budget surplus and raised long-term interest rates. Not so fast, Tom. Economists agree that cutting taxes and running a loose fiscal policy during a recession is a good thing. Besides, the biggest tax cut that went into effect last year was the rebate, which Democrats favored along with Republicans. President Bush's big tax cuts come in 2004 and 2006. As for the switch from surplus to deficit exerting pressure on long-term rates—well, maybe. The prospect of economic recovery could have lifted rates, too. And while interest rates did fall after Bill Clinton raised taxes and pushed the budget into surplus, they also fell when Ronald Reagan cut taxes, deepening the budget deficit.

Bush's response to Daschle—that he would allow Democrats to tamper with his cuts and raise taxes “over my dead body”—is equally partisan. It is true that many taxpayers at the top end are paying nearly 50% of each marginal dollar earned to government. They deserve a break. But the President's own tax cut reverses itself in 2011, raising all income, estate, and marriage-penalty taxes back to 2001 levels.

So taxes are already scheduled to go up. People forget, including, perhaps, the President.

The fact is that two schools of economic thought lie at the Sturm und Drang of the current political battle. Democrats believe that cutting taxes generates growth. Republicans believe that cutting deficits bolsters growth. The evidence for both beliefs remains mixed.

The only certainty is that all tax legislation gets enacted because real-world circumstances change. The shrinking budget surplus is one of those circumstances. Last year's estimate for the surplus was \$5.6 trillion over 10 years. The new law will take \$1.7 trillion out of that sum (\$1.3 trillion for tax cuts plus \$400 billion for the extra interest on the federal debt that must be paid because of the tax cut). Higher spending on social security is expected to take an additional \$400 billion from the surplus over 10 years. But the real surprise is an anticipated \$1.5 trillion hit to the surplus from the current recession. Because it is coming at the beginning of a 10-year period, the recession lowers the base on which forecasts of economic growth and tax revenue follow. The surplus estimate is for about \$1.9 trillion over 10 years. That's still a nifty sum. But not if you want to pay off the national debt, transform the military, give seniors a prescription drug entitlement, and bolster Social Security and Medicare.

No one figured the recession would have this kind of impact. But it has—and politicians will have to deal with it regardless of their beliefs. When the partisan rhetoric ends and the elections are over, choices will have to be made about taxes and spending. Sensible people know this.

ONE ACCOUNTING CODE FOR ALL

Whom can you believe? Four hundred companies have restated their earnings in the past three years, devastating investors. Thanks to increasingly lax standards, it now takes a forensic accountant to even attempt to make sense out of Corporate America's books. One result is the kind of disaster that enveloped Enron Corp.—an implosion that quickly destroys a company and wipes out tens of billions of investors' dollars. An even greater danger may lie in the slow erosion of credibility of more viable companies that use opaque financial-reporting systems to stretch the truth about their earnings and leave investors in the dark. The reputation of Cisco Systems Inc., for example, as a high-tech growth machine is based on accounting practices that are perfectly legal but are so murky that they cast doubt on past performance and rosy predictions for the future (page 54). Is Cisco's stock really worth 95 times estimated calendar earnings when Microsoft and Oracle, which do not use malleable pro forma financial statements, have price-earnings ratios in the high 30s?

The problem is that no one really knows, and that's setting the stage for a big investor backlash. As accounting gimmicks spread beyond the tech sector, investors are becoming increasingly nervous about the quality of financial reporting issued every quarter. They see revenues generated through manipulating reserves, interest, and nonoperating income. Income is being pumped up by excess inventory previously written off as worthless. Investor flight to quality earnings is building momentum, and some are beginning to demand dividends as tangible proof of a corporation's actual earning power.

Corporate execs complain that current generally accepted accounting principles do not accurately take into account cash flow and operating income. They are right. The SEC, the SEC and Exchange Commission and the Big Five accounting firms must come up with a uniform standard that addresses this important issue. But until they do, companies that play games with their numbers run the risk that investors will see them as losers and take their money elsewhere.

January 28.



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ACCOUNTING IN CRISIS

WHAT NEEDS TO BE DONE

IS: THE
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We're not suggesting the all-new Lexus ES 300 should hang in the Louvre. But as an outstanding example of the carmaker's art, it's most certainly worthy of attention. Artful design is apparent in the sleek new body of the ES 300, which has been totally styled for improved aerodynamics as well as aesthetics.

Inside the passenger compartment, you will find a whole new world of luxury. The cabin itself is roomier and trimmed in leather* of a quality that's normally reserved for sedans costing far more. Run your hand along the sculpted contours of the driver's seat — the seams almost feel hand-stitched. Burlled walnut accents adorn the dashboard, the console and the door panels. Sophisticated sound absorption technology creates a hushed atmosphere, in the quietest ES 300 cabin ever. But, with the option of a Mark Levinson® Premium Sound System, one

of the finest audio systems possible, you may find quiet moments an all-too-rare occurrence.

In their effort to engage all of your senses, Lexus engineers haven't overlooked the most important one: your sense of safety. To that end, a new, three-stage driver's-side airbag and new full-length side-curtain airbags

have been added, which help provide protection in the event of a severe frontal or side-impact collision.¹

Admittedly, the new ES 300 is not the kind of art you simply want to sit in front of and

admire. This automobile calls out to be driven. And with a 210-horsepower V6 engine mated to a new, five-speed automatic transmission, it could certainly qualify as performance art.

But perhaps the question we posed earlier is best answered by yet another question.

What better place to mull over what passes for art these days than behind the wheel of an automobile that has the power to move you?

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BE CONSIDERED
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GE's Immelt takes a global survey of business prospects page 102



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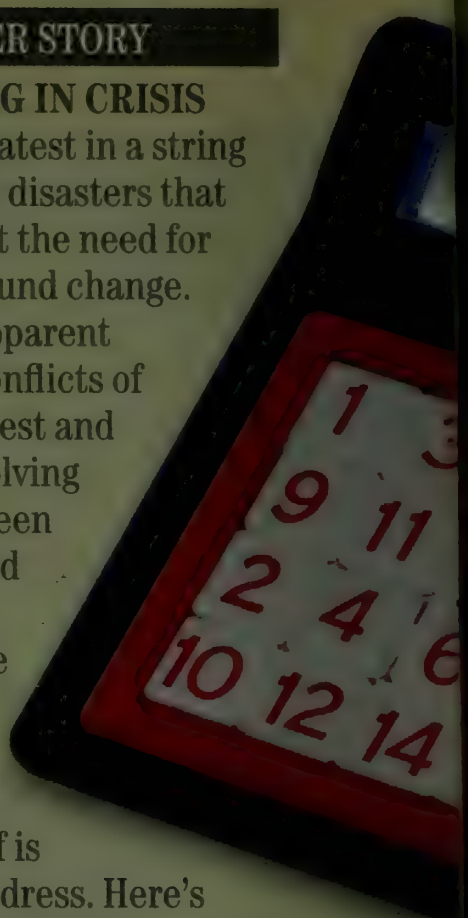
ACCOUNTING IN CRISIS

Enron is the latest in a string of accounting disasters that highlight the need for profound change.

Apparent conflicts of interest and

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Single-Minded Killers

Monoclonal antibodies zero in on exactly the disease-causing cells that need attacking. After years of false starts, the biotech companies could make a killing, too



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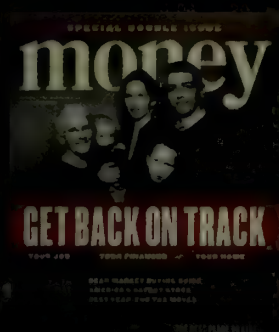
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Employment Trends: In our two-part survey of 2002's job outlook, a wide-ranging panel of experts has at least some good news





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Up Front

EDITED BY SHERIDAN PRASSO

SLUGFESTS

HEWLETT: SHOW ME CARLY'S MONEY

GET READY FOR THE NEXT round in the venomous public battle between Hewlett-Packard and board-member Walter Hewlett, who is leading the fight to kill HP's proposed purchase of Compaq Computer. The topic: HP CEO Carly Fiorina's post-acquisition employment contract. In previous filings with the Securities & Exchange Commission, HP said it was negotiating a richer deal for Fiorina, which would reflect the job of running a larger company. But in the latest filing, on Jan. 14, HP now says it will negotiate



FACE-OFF: Fiorina, Hewlett

the contracts for Fiorina and five other execs "following the completion of the merger." The same goes for Compaq boss Michael Capellas and four of his execs.

Such details count. Corporate governance experts say shareholders have a right to know what top brass will earn before they vote. But given

TALK SHOW "I am incredibly nervous that we will im in a wave of accounting scandals."

—Sherron Watkins, an Enron vice-president, in an August letter to Enron CEO Kenneth Lay (page 34)

Fiorina's already-rich package of roughly \$70 million in salary and options in her first two years, critics charge HP is trying to avoid antagonizing shareholders. Any big raises may not go over well, since HP's stock has fallen 60% since Fiorina took over in July, 1999.

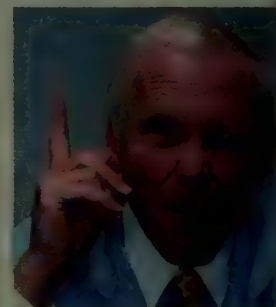
Now *BusinessWeek* has learned that Hewlett—a member of the committee that drafts compensation—wants HP to release contract intentions before the shareholder vote, which could come in March. The likely first stop: the SEC. Says Hewlett's lawyer, Stephen Neal: "It's clearly material information, and the SEC ought to make them make it public." *Peter Burrows*

HONCHOS

WHY CHAINSAW OPENED HIS WAL

THOSE WHO KNOW "CHA Al," the former Su chairman accused of c the books, say he's a ous cheapskate. So w Al Dunlap agree on J to pay \$15 million a share in the settlemen class action brought b beam shareholders?

It's a good question, cially because it's u Dunlap would have p pay a penny of his est \$125 million net worth he lost the case. That cause under Florida



assets jointly **DUNLA** owned by a *Still fo* husband and a *civil* wife are "judg- ment-proof." Only the of Dunlap's wife, Judy divorce would have ma covery of the alleged l ion in damages pos Dunlap's attorneys m clear that he "has a marriage and his wife excellent health," says tiffs' attorney Robert reich, "so we probably c reach those assets."

Despite that, legal e say, Dunlap probably that if a jury had foun guilty of fraud, it wou devastating for him in pending civil case broug the SEC. It alleges that lap and other officers er in massive financial fr trial is set for 2003. I admitted no wrongdoi the settlement and insis innocent. *John A.*

SEPTEMBER 11

WHO GETS DISASTER AID? WHO DOESN'T?

BUSINESSES AROUND THE World Trade Center, we know, were crippled by the terrorist attacks. And since September 11, the Small Business Administration has doled out \$200 million in loans to help them recover.

Yet it's not just mom-and-pop shops near Ground Zero getting these 30-year loans at 4%. An Oct. 22 decision by President Bush to make the whole U.S. and its territories a "disaster zone" made affected small businesses nationwide eligible, too. So since then, the SBA has granted more than 1,000 loans totaling \$95 million outside metro New York. One-third of them have gone to Florida, where businesses say they've been hurt by the resulting plunge in tourism. Even companies in far-away Guam, five in all, have gotten loans totaling \$156,000.

Some examples: Fast Lane Clothing, a beach-

wear maker in Tampa, claimed \$168,000 after the cancellation of a September trade show at which it expected to book orders. "Tourists weren't traveling, so we weren't selling," says CEO Lori Davis. Adds Bob Odell, founder of Real World

Diving in Guam, which received an SBA loan: "All of our tourists dried up."

To give more businesses a shot at loans, the SBA extended a Jan. 21 application deadline to Apr. 22. "Business owners were trying to weigh the options. 'Do I take on more debt? What do I do?'" says an SBA spokeswoman. "This is going to take some pressure off." *Brian Grow*

THE LIST RELIEF FOR SMALL BUSINESSES

Small businesses outside New York City received \$95 million in disaster loans.* Ones in these states got the most:



STATE	NO. OF LOANS	VALUE OF LOANS MILLIONS
FLORIDA	313	\$23.2
CALIFORNIA	89	7.1
MASSACHUSETTS	47	5.2
TEXAS	45	4.8
NEW JERSEY	42	5.6
NEW YORK (non-NYC)	40	4.4
PENNSYLVANIA	37	4.6
GEORGIA	37	3.8
OHIO	24	1.7
COLORADO	21	3.6

*Since Oct. 22

Data: Small Business Administration



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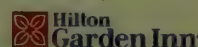
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Up Front

OVER THERE

ONE CURRENCY, MANY PINK SLIPS?

DOES THE INTRODUCTION OF the new single currency in Europe mean the prospect of thousands of unemployed central bankers? Could be.

CENTRAL BANK SURFEIT

The euro zone's central banks are still fat with highly paid workers

	NUMBER OF STAFF
DEUTSCHE BUNDESBANK	16,074
BANQUE DE FRANCE	15,265
BANCA D'ITALIA	8,515
EUROPEAN CENTRAL BANK	1,040

Figures are for 2001

Data: Central banks, Morgan Stanley Dean Witter & Co.

The 12 countries of Europe using new euro notes still have 12 independently functioning central banks with their own governors and 56,000 employees who earn

\$4.2 billion a year. That's more than twice as many people employed by the U.S. Federal Reserve System, which serves a larger economy. Bank of Italy Governor Antonio Fazio alone makes \$700,000, more than quadruple Alan Greenspan's salary.

The European Central Bank now sets the euro's interest rates and monetary policy. The national banks are meant to carry out ECB decisions. But the European Center for Integration Studies in Bonn says this division of labor is inefficient and in need of reform. Without francs, marks, and guilders to manage, the only responsibilities of national

central bankers now are controlling money flow, collecting data, and, in some cases, supervising local banks. Does that really require 56,000 people? *David Fairlamb*

PUDGEBALL NATION

AT LAST, TAX BREAKS FOR TUMMY TUCKS

DO YOU HAVE A NEW YEAR'S resolution to lose weight? And who doesn't (chart)? You might be heartened by a recent U.S. Tax Court decision.

Special Trial Judge Carleton Powell ruled in December that surgery to remove hanging skin left after a woman's 100-pound weight loss was tax-deductible. Powell overruled the Internal Revenue Service, which called the woman's surgeries cosmetic and therefore not deductible.

Before you rush out for a tummy tuck, note the extenuating circumstances. The woman, an emergency-room nurse in Roanoke, Va., said the skin spilled onto her thighs and interfered with

bending, running, and other activities required in her job. It was also susceptible to sores and infections. The judge agreed, allowing \$7,691 in surgical costs as a medical deduction.

Tax lawyer Stephan Leimberg, who publicized the rul-



BELLYING UP for liposuction

ing in his online newsletter for financial professionals, says that it clarifies the tax distinction between what is treatment for an illness vs. what is merely cosmetic. Says Leimberg: "It's a recognition that obesity is a serious disease." *Carol Marie Cropper*

DRAWN & QUARTERED



ZINE SCENE

A MEDIA WATCHDOG GETS TO BARK AGAIN

HERE'S A SCENARIO: THE COMPANY YOU WORK FOR CRUMBLES, but you really, really like your job. If you're the veteran of *Media Grok*, an irreverent e-mail newsletter published by the now-defunct *Industry Standard*, you stay your desk. With seed funding from MP3.com founder Michael Robertson and another angel investor, the seven writers launched a new version, *Media Unspun*, on Jan. 4. In a measure of the previous newsletter's popularity, they signed 10,000 subscribers within a week.

For four years, *Media Grok* turned out witty daily assessments of the biggest dot-com news stories for free about 100,000 people. When the Internet bubble burst, *Media Grok's* parent went bankrupt. The last e-mail went out September.

Don't look for free content from the new iteration, though. Starting March, a yearly subscription to *Unspun's* daily summaries of tech-business news will cost \$50. In the first issue entitled "Cheer Up! At Least You're Not Enron," *Unspun* assessed articles about the failed giant from 10 publications, including the *Houston Chronicle* and *Financial Times*. Says Jimmy Guterman, editor of both the old and new newsletters: "We went from 'Wouldn't it be nice to keep doing this?' 'Wouldn't it be nice if someone would pay us?' to 'Let's just do it.'" Well, either that or find a new job. *Heather Gro*

THE BIG PICTURE

FRESH START

Percentage of Americans saying the most important thing they could do in 2002 would be to:

LOSE WEIGHT/EXERCISE MORE

REDUCE DEBT

IMPROVE PERSONAL RELATIONSHIPS

GET A BETTER JOB

QUIT SMOKING/DRINKING

NOTHING

OTHER

PERCENT

TELEPHONE SURVEY OF 1,000 ADULTS, WEEK OF DEC. 31

Data: ICR/International Communications Research

Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com

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GAZING INTO THE STOCK MARKET

After two years of extensive economic analysis, I have uncovered three critical facts about the market: (1) Analysts are liars. (2) You can't time the market. (3) Companies without earnings are not good bets ("Where to invest," Cover Story, Dec. 31).

Armed with this powerful inside information, I still spent more than \$100,000 on tech stocks last year—which leads me to another critical point: Greed always overrules common sense.

I would have been better off by waiting for December to arrive, buying a copy of *BusinessWeek*, and reading the annual "Investment Outlook Scoreboard." Thanks for the great insights.

Tom Viegandt
Mississauga, Ont.

"This recovery will be a slog" ("Where to invest," Dec. 31), with its tremendous range of "predictions," clearly displays the fact that these forecasts are really "educated guesses."

Joseph Carro
Paso Robles, Calif.

"The power of negative thinking" ("Where to invest," Dec. 31) expressed bewilderment that forecaster James W. Paulsen's predictions for 2001 were so negative, [even though] they proved to be so accurate. Paulsen presented a valuable and realistic analysis of what the future might actually hold. Unlike the majority of his peers, he offered realism rather than unbridled optimism.

Rather than being an errant negative voice that by fluke was accurate, Paulsen was sound in his approach. The others marched like wide-eyed optimists in lock-step. In an environment that traditionally passes through peaks and troughs, why

do you seem to have so much doubt for the bearers of news other than bright and well in the business world?

Greg W.
Puste Sady, SL

WHY WILLAMETTE ISN'T GIVING IN

"It's time for Willamette to go to Weyerhaeuser" (News: Analysis Commentary, Jan. 14), dealing with Willamette Industries Inc.'s deal against Weyerhaeuser Co.'s hostile takeover, misstates our position. Weyerhaeuser has attempted to force Willamette into selling its business for less than the board believes the company is worth. Willamette has remained based on its commitment to ensure stockholders receive full value for their shares. The board's record of delivering industry-leading returns is very strong, and we believe our strategy will continue to deliver superior value.

Your article claims I have "argued" that the Georgia-Pacific Corp. deal is the only way to "make Weyerhaeuser go away" and that I would "never" to [Weyerhaeuser CEO Steven] Rogel." This is absolutely untrue, and challenge you to document when I said anything of the sort. Although unlikely that I would feel warm toward any person who undertakes a hostile takeover, it is preposterous to suggest that I, or any other member of Willamette's board, would let personal animosities prevent us from considering the best interests of Willamette stockholders.

Your claim is further undermining the fact that we recently entered discussions with Weyerhaeuser to reach an agreement. *BusinessWeek* entitled to its opinion about wh

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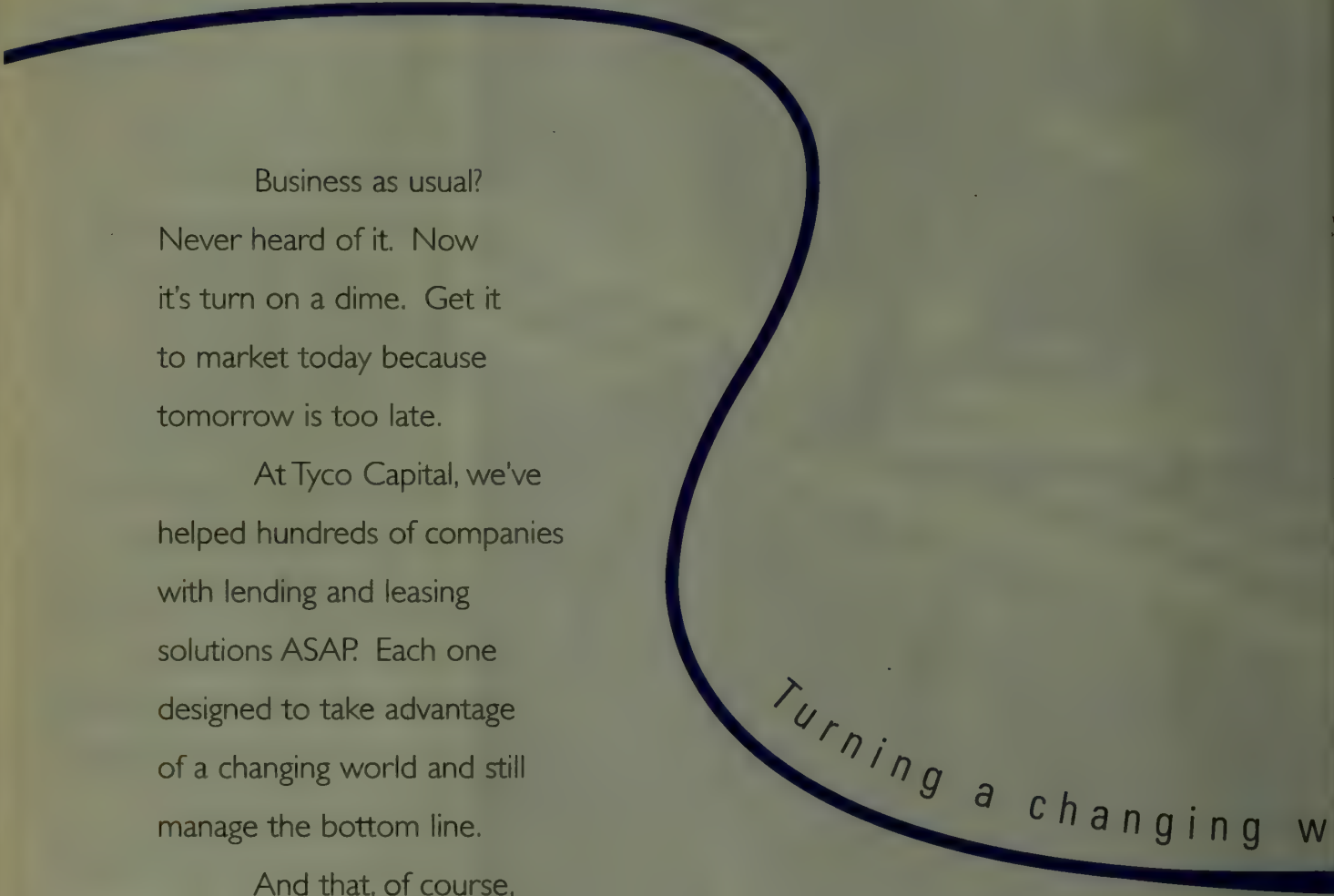
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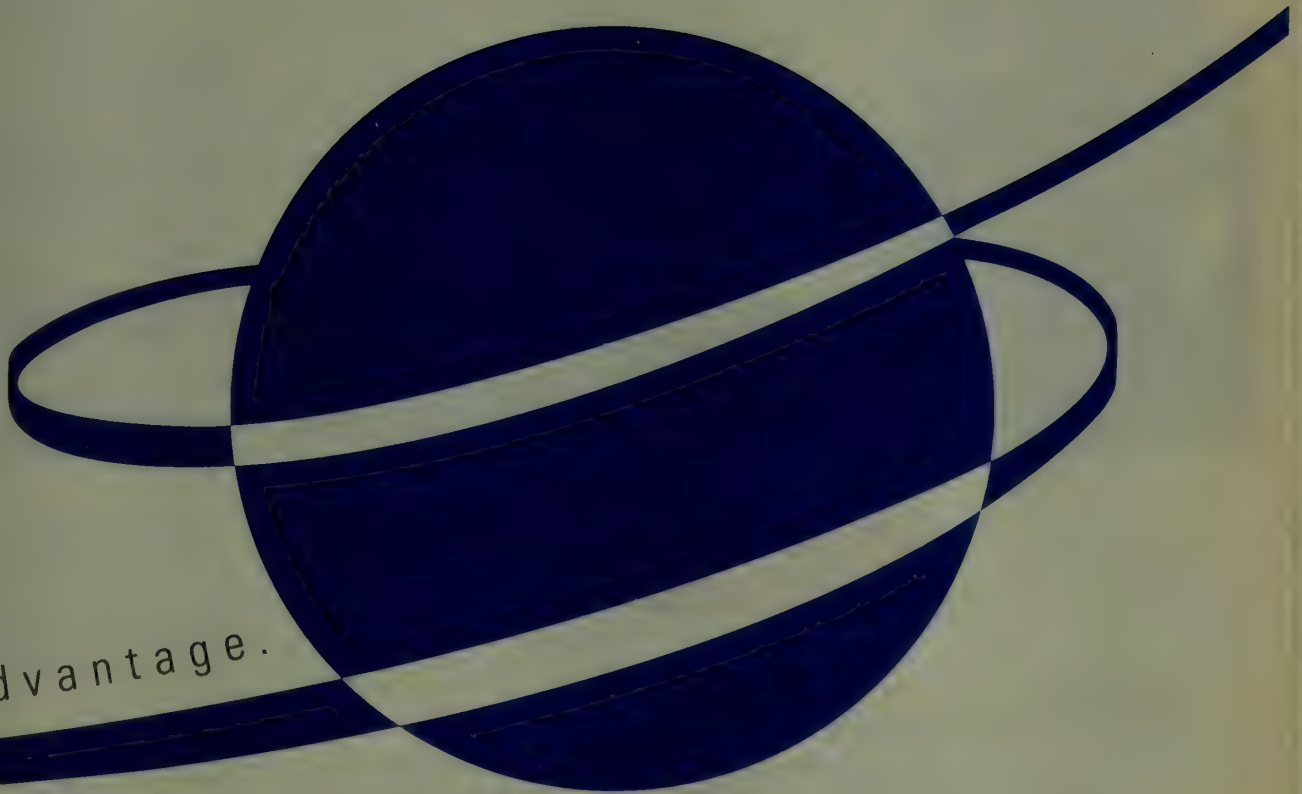
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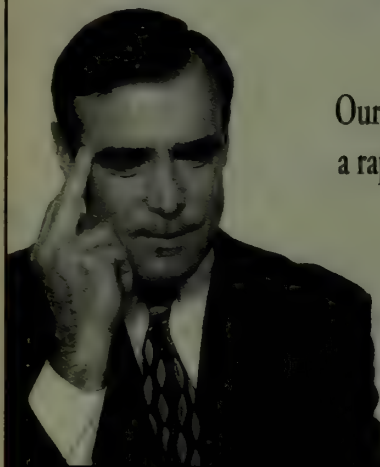


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Readers Report

CORRECTIONS & CLARIFICATION

"Acacia is all set to blossom" (Inside V Street, Dec. 31) should have said Acacia Research has pacts with leading TV makers, "except for Sony and Mitsubishi," rather than "including Sony and Mitsubishi."

best for Willamette's shareholders, the truth is that Weyerhaeuser is simply not willing to pay what we believe is a full and fair price for Willamette.

William Swindells
Chairman of the Board
Willamette Industries
Portland, Ore.

Editor's note: We erred in stating Swindells has argued that a merger with Georgia-Pacific would be the best way to thwart a hostile bid by Weyerhaeuser. But several sources tell BusinessWeek that Swindells did not want to sell to Rogel.

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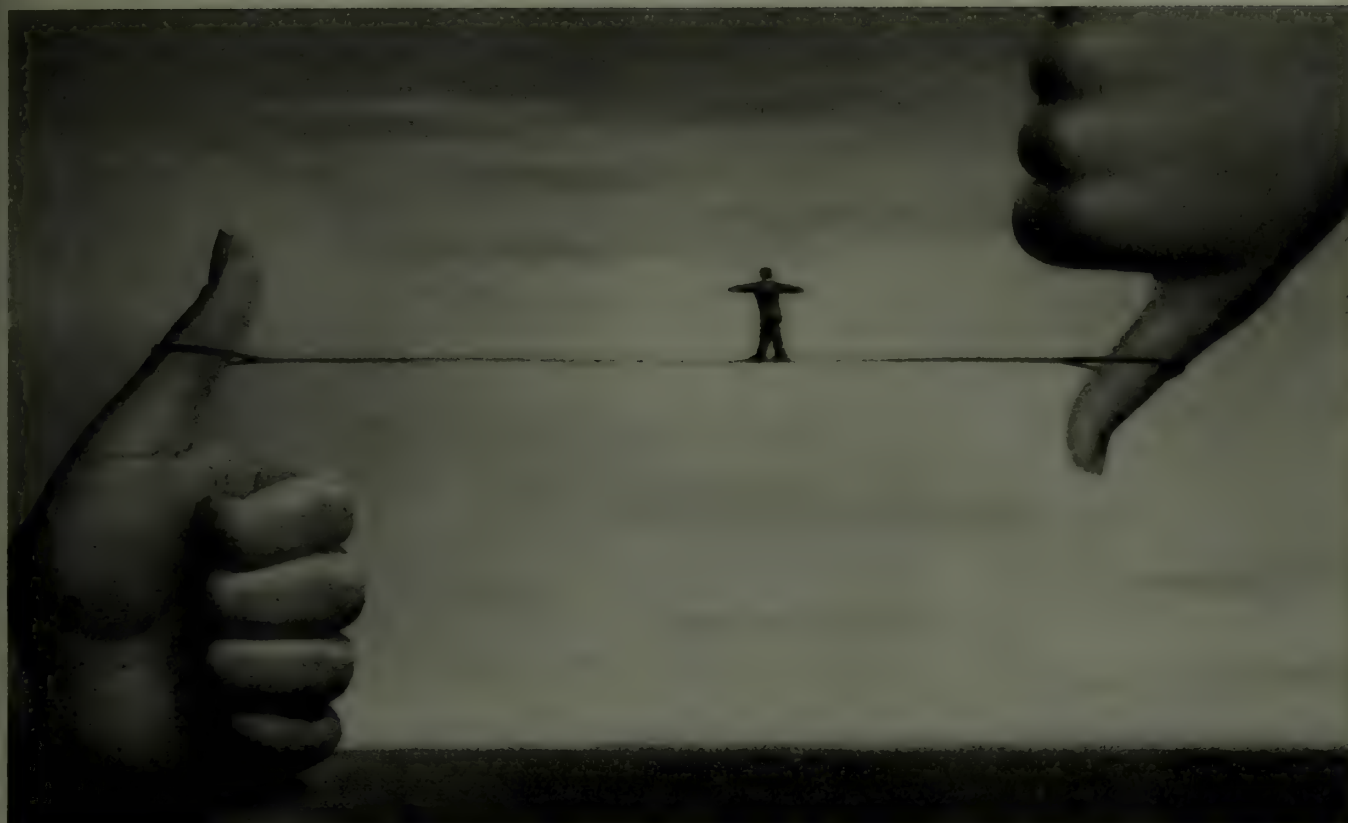
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A close-up, high-contrast photograph of an owl's face in the dark. The owl's large, yellowish-orange eye is visible on the right side, looking directly at the viewer. The feathers are dark and textured, with some highlights catching the light. The background is almost entirely black, emphasizing the owl's features.

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HOW THE ISLAMIC WORLD LOST ITS EDGE

Early Islamic civilization greatly benefited from scientific works of the ancient Greeks and Romans, but later Muslim scholars took a more insular approach. "In the prevailing view, the corpus of medical knowledge had reached perfection in the days of Avicenna," a Persian who died in 1037, writes Middle East scholar and Princeton University emeritus professor Bernard Lewis. One exception was syphilis, known as the "Frankish pox," which the Muslim world believed came from Europe. "It was therefore acceptable to translate European writings on the diagnosis and treatment of this disease," Lewis writes. Unfortunately, the volumes given to the Turkish Sultan in 1655 were largely based on work that was already a century old.

This vignette is typical of Lewis, whose *What Went Wrong?: Western Impact and Middle Eastern Response* argues that Islamic culture has largely itself to blame for a long period of decline. Lewis' take is erudite, amusing, and nasty. He indulges in sweeping generalizations. Yet for all its faults, this volume is a timely and provocative contribution to the current raging debate about the tensions between the West and the Islamic world.

Lewis traces today's "seething anger" among Muslims to the Islamic world's catastrophic loss of influence and power to the West, which began in about the 15th century. He also notes that Muslim leaders perceived the slide and tried various strategies to halt it, to no avail.

Finding themselves at first unable to keep pace with the West and later falling under its domination, Lewis argues, residents of the Islamic lands grew increasingly embittered. Over time, they came to blame foreign villains—the Europeans, the Jews, the Americans—for their shortcomings. Islamic fundamentalists also blame their

cultures' supposed "abandonment of the divine heritage of Islam" and demand "a return to the real or imagined past."

At the peak of Islamic power, in the 9th through 13th centuries, Lewis says, Islam "represented the greatest military power on earth—its armies were at the same time invading Europe and Africa, India and China. It was the foremost economic power in the world.... It had achieved the highest level so far in human history in the arts and sciences of civilization." The reversal since then has been quite remarkable. In the 19th century, the Western powers began colonizing the Islamic world, and after World War I, they sliced up the Ottoman Empire. The second half of the 20th century "brought further humiliations." Residents of the Islamic world found themselves surpassed in living standards and technical prowess by Asia. What's more, the Arab countries were unable "to prevent half a million Jews from establishing a state in the debris of the British Mandate for Palestine—all the more of a shock."

Lewis produces some choice vignettes of Islam's encounter with the West. In the late 17th century, a Turkish visitor to Vienna reports "an extraordinary spectacle": the emperor taking off his hat to a woman in the street. "In this country and in general in the lands of the unbelievers, women have the main say," the writer concludes. About 80 years later, another Ottoman diplomat in the same city describes what seems to have been an early experiment with electricity. "The whole thing is merely a plaything, we did not think it worthwhile to seek further information," he says.

Islamic leaders could see that they were losing their edge. As early as the

15th century, an Ottoman Grand vizier warned that the infidels were gaining naval superiority. The Ottoman empire tried many remedies. It acquired Western arms. It brought in Western technocrats. In 1830, a British officer in the Bosphorus was astonished to hear a military band playing. The reforming Sultan had gone the mile in seeking foreign help, even hiring an Italian conductor to train his marching band.

But none of the remedies worked, Lewis argues. Despite efforts at imitating Western economies, today the ports of the Arab world aside from amount to no more than those of a land. When imposed in the region, the European nation-state model largely produced impoverished tyrannies.

Lewis attributes the gulf that gradually widened between the Islamic world and the West to "greater, more profound" differences than could be explained by mimicry. Western society allowed individual far more freedom and

place severe restriction on women, spawn rapacious religions, and lack a separation between religion and state.

Persuasive as Lewis may be, readers should be wary. The book largely depends on evidence from Turkey, which had considerable success in building a modern society. Meanwhile, Lewis' main targets are the Arab countries

Iran. The shortcomings he identifies apply to many of these lands, but so do their woes stem from other sources. Why not, for instance, blame the Ottoman Empire, which, when it collapsed in 1918, left its people unprepared to cope with modernity. Cold war rivalry also led Middle East states to spend on weaponry rather than development.

Still, one wishes leaders in the Islamic world would pay heed to some of Lewis' themes. He says that "growing numbers of Middle Easterners" are adopting "a more self-critical approach, asking 'what did we do wrong?' 'how do we put it right?'" He provides discouragingly little evidence of this trend, but one hopes that he is right.

BY STANLEY I.

London Bureau Chief Reed of the Middle East.



LEWIS IS CONVINCED THAT MUSLIM CULTURE IS TO BLAME FOR A SLOW DECAY

STEPHEN H. WILDSTROM

you@businessweek.com

IS THERE LIFE OUTSIDE MICROSOFT OFFICE?



There are alternatives to the ubiquitous applications, but in most cases, you're not with the able

Do you need to have Microsoft Office on your PC? Because Word, Excel, and PowerPoint have become the *de facto* standards for word processing, spreadsheets, and presentations, it's tough to do any sort of business on a computer without being able to read and edit files in those formats. But if you're willing to make some compromises, there are alternatives.

The main complaints I hear about Office concern its cost. Office XP Standard costs \$479 new, \$239 for an upgrade. The Mac equivalents are \$429 and \$239, respectively. A special "small-business edition," which lacks PowerPoint, is much cheaper but can be purchased only with a new computer, typically as a \$150 to \$200 option. If you're just interested in word processing, Microsoft's little-known Works Suite contains a full copy of Word and is an excellent buy at less than \$100.

My principal criterion for an acceptable Office substitute is that it be able to open, create, and save files in Word, Excel, and PowerPoint formats with as little fuss as possible. Two old Office competitors, now reduced to minuscule market shares, can both do a reasonable job. But while cheaper than Office, Lotus SmartSuite, at about \$390, and Corel WordPerfect, at about \$340, remain fairly expensive. I took a look at two much cheaper alternatives, ThinkFree (www.thinkfree.com) and StarOffice (www.staroffice.com). I skipped another alternative, gobeProductive (www.gobe.com) because it lacks PowerPoint support.

ThinkFree is sold as a \$49 annual subscription that includes 20 megabytes of online storage. You can download a trial version for Windows, Mac, or Linux and use it 30 times before being required to pay. A retail version should be available soon for about \$70. The program can be configured to open and close Office files by default. The individual applications lack some features of their Office equivalents, but they're adequate, especially for casual users. What I missed most was Office's outstanding spell checker.

I ran into two big problems. ThinkFree couldn't display some complex Word pages properly. It put images in the wrong place, for example, and mangled complicated tables. More seriously, the current version doesn't understand the way Windows stores user files in the My Documents folder. In fact, if you're using Windows 2000 or XP, it takes several clicks in the file-save dialog just to find My Documents.

Version 2.0, now in trial, is an improvement, but it doesn't fix the problem.

Where ThinkFree tries very hard to look and feel like Office, Sun Microsystems' StarOffice 5.2 for Windows, Linux, or Sun's Solaris (free as a 77-MB download, \$36.99 for a CD) goes its own way. In fact, in its default installation, it will pretty much take over your computer desktop, adding a Web browser and e-mail program to the standard applications. It offers a lot more features than ThinkFree. StarOffice's word processor, for example, correctly handles proposed alterations made using Word's "track changes" feature, which is widely used in business to collect comments on drafts. ThinkFree simply displays the document as left by the last reviewer, with all traces of editing erased.



The price for StarOffice's power is complexity at least as great as that of Office, made worse by the unfamiliarity of the program's design. In addition, while StarOffice can be set as the default application to open Office documents, there's no simple way to save StarOffice files in Office formats automatically. When you do it manually, the program warns you that some formatting may be lost.

In the end, if you must work with Office files regularly, there really is no substitute for Office itself; the savings just aren't worth the hassle. But if you are looking for a program for word processing and simple spreadsheet or presentation work at home, ThinkFree could be a good choice. And either ThinkFree or StarOffice might make sense for a small business seeking an inexpensive option to Office. But while both programs have their uses, neither poses much of a threat to Microsoft's near-monopoly. ■

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BY JEFFREY E. GARTEN

LET'S END OUR DANGEROUS DEPENDENCE ON THE SAUDIS



WHY WAIT?
A White House push for fuel-efficient cars and more oil from Russia would go a long way toward safeguarding the U.S.

Among the critical problems that Congress should address when it returns on Jan. 23 is American energy policy. Thus far President Bush has emphasized increasing production in the U.S., while giving short shrift to the potential for conservation. And since the September 11 attacks, there is another big shortcoming to the Administration's plan—it keeps intact our dangerous dependence on Saudi oil. Now it's time for some tough decisions involving both foreign and domestic policy.

Saudi Arabia supplies 14% of our petroleum imports. However, its real leverage comes from its 2 to 3 million barrel-per-day surplus capacity and its willingness to turn its own spigot on and off to keep oil prices within relatively moderate ranges. When it fails to act, as it did two years ago, prices can soar and play havoc with our economy. The crucial Saudi swing role is why the Bush Administration tolerates the kingdom's policies of subsidizing Islamic fundamentalism in its schools and abroad, as well as the involvement of Saudi citizens in a number of major attacks against Americans, including September 11, over the past seven years.

Outside the Administration, a number of American foreign policy experts have been demanding that Saudi Arabia reform its religious schools that breed intolerance, cease supporting extremists, and grant its people more political freedom. Sounds good, but these prescriptions are no more than a wild leap of faith that so radical a transition could occur peacefully and with oil supplies still being managed in America's interest. After all, not only is the kingdom in a political earthquake zone, but the Saudi leadership is ripe for destabilization owing to its living in luxury even as the country's per capita standard of living has dropped by half since 1980.

The precariousness of Saudi Arabia as an ally now means that the Administration should view reducing our links to it as an essential outcome of the anti-terrorist campaign. We may not be able to achieve total energy independence, and with 25% of the world's reserves, Saudi Arabia will always remain a big player in oil markets. But we should do much more to reduce our strategic vulnerability.

For starters, Washington and Corporate America should help Russia accelerate its production and its exports to undermine Saudi Arabia's role as the pivotal swing producer. Russia could become the world's largest oil producer this year and it could expand its output by at least half its current 6.9 million barrels per day

within the next several years. Russian energy production has already been increasing rapidly, but to expand them even more, Moscow needs billions of dollars of investment in pipelines, ports, and related transportation infrastructure. For its part, U.S. companies need a more favorable and regulatory environment from Moscow as well as more equitable production-sharing agreements before they will seriously invest. In the wake of the post-September 11 improvements in Washington-Moscow ties, now is the time to intensify efforts to strike a cooperative deal. For example, the U.S. and Russia could perhaps negotiate some long-term supply arrangements. The U.S. could begin with giving preference to Russia in filling our strategic reserve as a *pro quo* for more accommodating Russian investment rules in the energy sector.

We also need to enlarge and revamp the national system of holding emergency stocks. America's strategic stockpile should be doubled to reach at least 1 billion barrels, or 90 days' worth of imports. The U.S. should also encourage energy exporters such as China, Brazil, and India to build larger reserves. Washington should then prepare coordinated management of all these stocks to be prepared to use them to influence prices. This would constitute a sharp change of policy, since to date the industrial nations have only turned their stocks aside as insurance against any major supply disruption.

Bush needs to focus on energy conservation at home, too. The Administration is pushing research on fuel cells as an alternative to the guzzling internal combustion engine. Unfortunately, the payoff will be decades away. A higher tax at the pump would help cut consumption, but that's probably a political nonstarter, especially in the wake of Bush's recent "over-the-dead-body" declaration about new taxes. The best alternative is to legislate higher mileage standards, which have now reached their lowest levels in two decades. Tax breaks for purchasing hybrid electric-gasoline cars that get upwards of 50 miles per gallon—already a goal—should also be considered.

Are these three measures unrealistic? More so than thinking that we can close our eyes and maintain the status quo with Saudi Arabia. As Edward Morse, who chaired the recent Council on Foreign Relations study of strategic energy options told me: "The biggest risk is in doing nothing." Yet unless some dramatic measures are taken soon, that's exactly the course we will be on.

Jeffrey E. Garten is dean of the Yale School of Management. A former investment banker, Garten is the author of *The Mind of the C.E.O.* (jeffrey.garten@yale.edu).

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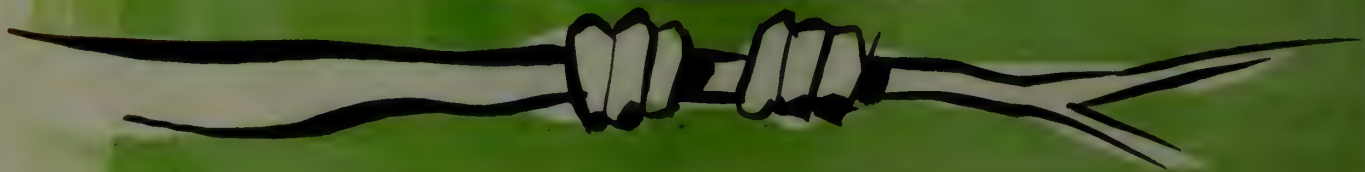


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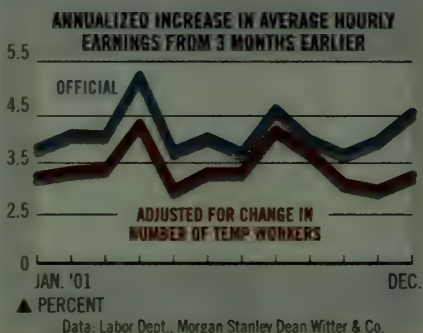
EDITED BY PETER COY

HOURLY WAGES ARE UP. SO WHAT?

It may not mean recovery is nigh

Economists have long viewed average hourly earnings as an early indicator of recovery. As business picks up, the argument goes, companies boost overtime pay or increase wages to attract new workers. From that perspective, the gauge offered something to cheer about in December. Average

A BETTER TAKE ON U.S. WAGES



hourly earnings growth for production workers rose at an annual rate of 4.5% for the three months ended in December, up from 4% annually for the three months ended in November.

In this economic cycle, however, hourly earnings aren't a good indicator of recovery, warns Richard Berner, an economist at Morgan Stanley Dean Witter & Co. He says hefty cuts in temporary workers skew the composition of the labor force of production workers toward higher-paid, full-time employees, artificially inflating gains. On average, temps earn \$8.66 an hour, vs. the \$15.69 earned by full-time employees in private industry, according to the Bureau of Labor Statistics. Berner calculates that the shift away from temp workers alone added almost 1.3 percentage points to fourth-quarter earnings growth (chart).

Corporate America's increased reliance on temp help during the past decade is astounding. Temp employment tripled from the end of the early-'90s recession, to a peak of almost 3.6 million in September, 2000. Companies turned to temps in part because it's easy to meet fluctuations in demand by adding or cutting them. Nearly 40% of those jobs were in manufacturing, estimates Manpower Inc., the top temp agency. That explains why the economy began

shedding temp jobs in October, 2000, well before the recession began in March. Temp employment mirrored the factory sector, which led this downturn, says Manpower CEO Jeffrey A. Joerres.

Maury N. Harris, UBS Warburg's chief U.S. economist, also cites the cut in temp jobs as a reason that earnings are overstated. Further skewing the data, he says, is that most of the recent job cuts have affected workers who have no more than a high school degree and therefore earn less than other workers.

The slower underlying growth in wages does have a silver lining, Berner adds. It is another sign that inflationary pressures from higher wages are still slight. That should help reverse the decrease in corporate profits, which tipped the economy into recession in the first place. Says Berner: "From that point of view, this is a bullish sign."

By Robert Berner

NO CONFIDENCE IN THESE INDEXES

The perils of gauging consumers

In tough times, consumer sentiment is widely watched as a signpost for what's ahead. When it comes to predicting whether Americans will keep shopping, two favored indicators are the University of Michigan's Survey of Consumer Sentiment and the Conference Board's Survey of Consumer Confidence. In 1996, UBS Warburg came up with a third, the Index of Investor Optimism, based on a survey of 1,000 investors conducted by the Gallup Organization.

For all the interest these surveys generate, you'd think they were pretty accurate predictors. It turns out, however, that the chance a trend they've spotted will come to pass is only slightly better than 50%, according to *The Index of Investor Optimism*, a study by Nobel prize-winning economist Lawrence R. Klein of the University of Pennsylvania and Penn visiting professor Suleyman Ozmcu.

The study showed that since 1997, the Index of Investor Optimism has had a slight but statistically significant edge on the more established indexes in predicting spending. Klein and Ozmcu found that investors are just a little bit better than the public at large at gauging the economy. And the most recent survey shows that they're feeling more upbeat.

To make a really good forecast, Klein recommends using this survey along

with 27 other indicators, including and bond market indexes, housing starts, and the unemployment rate.

By Margaret H.

FROM AMERICA BOOM-AND BUS

The U.S. economy's ripple effect

The U.S. has been the cause of growth and contraction in the economy in recent years. American boom helped power the global economy of the 1990s, and its slump helped drag down Europe and Asia. The effect was especially visible in manufacturing. European factories, for example, were doing fine until U.S. industry started shrinking in September. By December, 2000, the slump spread to Europe (table). And the Japanese output peaked in August, the factory recession in Japan didn't begin in earnest until December, when the U.S. slowdown bit.

A recent report by two economists at the International Monetary Fund went beyond manufacturing to quantify the importance of overall U.S. economic health for the rest of the world. B. Arora and Athanasios Vamvakaras looked at two decades of data for 100 countries. They found that an increase of one percentage point in the growth of U.S. output per capita was associated with an increase of 0.8 to 1.0 percentage point in the average growth of other countries. Decreases in U.S. output likewise lowered growth elsewhere.

Developing countries seem to be most sensitive to U.S. influence. "The U.S. had more impact on global growth than the European Union and far more impact than the Japanese. "Growth in Japan does not seem to have a perceptible impact on growth of other countries," they write.

It's possible that the European Union will become more influential as the euro takes hold. But for now, the rest of the world has a big stake in the ability of the U.S. to sustain the productivity gains of the 1990s.

By Michael J. Mandel

LEADERS IN THE DOWNTURN

	MONTH MANUFACTURING STARTED CONTRACTING
JAPAN	Aug.
KOREA	Aug.
UNITED STATES	Sept.
UNITED KINGDOM	Dec.
EUROPEAN ZONE	Dec.
ARGENTINA	Dec.
BRAZIL	Dec.

Data: DRI-WEF

AMES C. COOPER & KATHLEEN MADIGAN

DON'T BE FOOLED BY THE BOUNCEBACK FROM SEPTEMBER 11

Until capital spending stops falling, there will be no healthy recovery

U.S. ECONOMY In his first public remarks on the economy since October, Federal Reserve Board Chairman Alan Greenspan sounded decidedly cautious when he discussed recovery prospects on Jan. 11. In particular, he emphasized his conviction that "we continue to face significant risks in the near term," suggesting that he might favor another quarter-point cut in interest rates—if only as recovery insurance—at the Fed's Jan. 29-30 policy meeting. His somber tone was somewhat surprising to those investors who were beginning to think this easing cycle was over and that the Fed's next move would be a rate hike later this year. After all, the recent data seemed to bode optimism about a recovery. Consumer confidence picked up, and spending is surprisingly strong. Businesses are clearing out inventories at a record pace (chart). Factory activity is improving. Even the tech sector is shaking off some of its weakness.

COMPANIES CUT INVENTORIES SHARPLY



However, Greenspan seems to understand something that investors are overlooking: Two recoveries are under way right now. One is the sharp bounce-back from the September 11 terrorist attacks, the other a more gradual rebound from the demand slowdown and inventory overhang that began a year ago. The problem is that much of the upbeat data in recent weeks reflect the V-shaped rebound to the September shock. Focusing on the upswing of that V may exaggerate the strength of the turning upturn. Investors who look at the unexpectedly weak data and then bet on a robust recovery and strong turnaround may find themselves disappointed by year's end. A return of bearish sentiment on Wall Street could create a huge drag on demand in the second half as other stimulative factors, such as inventory reordering, are trying to boost growth.

GREENSPAN ALLUDED to the two-recovery idea when he said that economies around the world, including the U.S., seemed to be going through "a coincident deceleration in activity" over the past year owing partly to "retrenchment in the high-technology sector." There are hints that the slowdown was stabilizing before September, he said, but the attacks breached "the fabric

of business and consumer confidence." After the shock, "U.S. economic activity did drop dramatically."

To a great extent, that drop-off was linked directly to the attacks. For instance, a quarter of the 819,000 positions lost in October and November were in travel-related industries such as airlines, hotels, restaurants, and amusement parks, which account for 6% of all jobs. New orders plunged when executives, uncertain about the future, held off on making decisions. Consumers stopped shopping for a few weeks.

Now, the shock effect is dissipating, making the economic numbers look very good compared with their summer levels. But the firmer data may cause a misreading of the economy's underlying health.

THE BIGGEST DISTORTION may well be the dramatic drawdown of inventories combined with the increase in consumer spending in the fourth quarter. Bear in mind that companies were dealing with an inventory overhang well before the terrorist attacks. Through the first nine months of 2001, businesses had reduced their stock levels at the fastest three-quarter pace in the postwar era.

Then came September 11 and the consumer shutdown. Detroit responded by offering lucrative incentives. Record vehicle sales cleared out car dealers' lots. In November, business inventories fell 1%, after a 1.6% plunge in October. Both drops were concentrated in retail auto inventories. The steep inventory drawdown last quarter subtracted heavily from growth in real gross domestic product, perhaps more than two percentage points. Some forecasters expect that inventory liquidation for the fourth quarter alone nearly equaled the pace for 2001's first three quarters combined. Greenspan called the liquidation "extraordinary," a strong word for a man who tends to speak in generalities.

The key point is that consumer spending, mainly on autos, offset perhaps all of that drag. The Commerce Dept. won't release the GDP data until Jan. 30, but the numbers on retail sales and car buying through December suggest that real household spending grew in the neighborhood of a 4% annual rate last quarter (chart). That's a strong pace in any quarter and an



amazing result in the middle of a recession.

However, the incentives stole vehicle purchases from the first quarter. Car sales this quarter are surely dropping, and that will cause an outright decline in total consumer spending. For the rest of 2002, household demand is likely to proceed more slowly than the fourth-quarter pace, given rising unemployment and little additional room for growth in both autos and housing, the sectors that have always driven past rebounds in consumer spending.

At the same time, inventories will provide a lift to the economy. Businesses might not be ready to beef up their warehouses, but in the GDP math, a slower pace of inventory liquidation actually adds to real GDP growth. That boost will begin in the first quarter.

IN ANOTHER ALLUSION to the two-recovery notion, Greenspan noted that inventories and consumer spending "will have important consequences for the economic outlook in coming months." But looking further out, he said, "the broad contours of the present cycle have been, and will continue to be, driven by the evolution of corporate profits and capital investment."

Those segments of the economy were in trouble prior to September 11, and they face the toughest road. Although companies froze their capital-spending decisions right after the terrorist attacks, the problems facing equipment makers—overcapacity, bloated in-

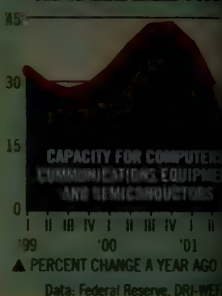
ventories, and excessive demand expectations—led to build in late 2000. Adjustments to these excesses will take considerable time to work through, and until capital spending stops falling, the U.S. economy cannot mount a healthy recovery.

Equipment manufacturers, especially in the tech sector, showed some improvement in the fourth quarter. Output of tech equipment edged up a bit, the first gain in a year. More important, tech manufacturers increased capacity by 12.9% from a year ago, the smallest addition in eight years (chart).

Total industrial production fell at a 7.2% annual rate last quarter, but the small 0.1% dip in December suggests that factory activity was stabilizing at yearend. If that is encouraging, it will take the January numbers to show whether that plateau reflects mostly the V response to September 11 or if manufacturing, and thus the rest of the economy, is truly getting back on its feet.

On that point, Greenspan sounded wary. "Despite a number of encouraging signs of stabilization," he said, "it is still premature to conclude the forces restraining economic activity here and abroad have abated enough to allow a steady recovery to take hold."

TECH CAPACITY GROWTH AT A SLOWER PACE



RUSSIA

IF REFORMS CONTINUE, SO WILL GROWTH

The Russian economy, fueled by business investment and household spending, continues to grow at a healthy pace. However, the global slowdown is taking a toll on exports and industrial activity, and growth in 2002 will cool. The key questions in the outlook: How much will lower oil prices affect growth, and how fast will economic reform efforts proceed?

Most economists agree with the International Monetary Fund's recent forecast of "reasonably healthy" 3.6% growth this year, down from last year's pace of close to 5% and well below the record 8.3% clip in 2000. That's when revenues from higher oil prices and the sharp

1998 ruble devaluation—following Russia's default on \$40 billion in domestic debt—ignited industrial output and business investment.

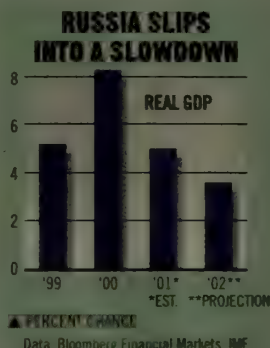
Growth was already slowing at the end of 2001. Real gross domestic product in the third quarter grew 4.9% from a year ago, less than last spring's pace. Monthly output data show more slowing in October and November, and a December survey indicates weak demand and bloated inventories.

Exports in all of 2001 fell about 3% from 2000, even as imports grew some 17%, reflecting strong domestic demand. Oil output and exports generate some 20% of Russia's GDP. The government says that 2002

GDP growth could dip below 3.5% if the price of Urals crude falls below the \$18.50 per barrel assumed in this year's budget.

Business investment is also slowing, but it is still growing at a solid pace. President Vladimir V. Putin's successful reform efforts on corporate taxes, business deregulation, and banking in 2000 are generating optimism among foreign investors that reform will continue apace in 2002.

These successes triggered an upgrade in Russia's credit rating in November, but further improvement will depend on continued progress, especially in the areas of private property, pensions, and the judicial system. Moreover, if Russia can tear down its array of trade barriers, membership in the World Trade Organization by 2003 would be a real possibility.





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CAN YOU TRUST ANYBODY ANYMORE?

The scope of the Enron debacle undermines the credibility of modern business culture. Let's get back to basics

by Bruce Nussbaum

There are business scandals that are so vast and so penetrating that they profoundly shock our most deeply held beliefs about the honesty and integrity of our corporate culture. Enron Corp. is one of them. This financial disaster goes far beyond the failure of one big company.

is corruption on a massive scale. enormous harm has befallen innocent employees who have seen their retirement savings disappear as a few top cashed out. Terrible things happened to the way business is conducted under the cloak of deregulation. Serious damage has been done to the ethical codes of conduct held by trusted business professionals. It is difficult not to contrast the professionalism of modestly paid firefighters and police doing their duty on September 11 with the secretive and corruptly behavior of six- and seven-figure accountants, lawyers, CEOs, bankers, and financial analysts who failed at their duty with Enron. The

remarkable letter by Enron whistle-blower Sherron Watkins to Chairman Kenneth L. Lay in August that presciently warns of accounting scandals reads like a road map of corporate corruption, subterfuge, and manipulation. She worries about the world perceiving Enron's "past successes as nothing more than an elaborate accounting hoax" (page 34).

The Enron debacle calls into question a host of other aggressive accounting techniques

used across a wide spectrum of Corporate America—most of them quite legal. And that's precisely the point. It's getting harder and harder to know what a company actually earns and what its stock is actually worth. An astonishing 723 companies have been forced to restate and lower their earnings since 1997. With enormous pressures to produce earnings growth, auditors are being turned into enablers. They forsake their traditional role of outside skeptic for that of inside business partner and they reject their age-old function of discloser of information for that of master magician who hides the financial rabbit (page 44).

Investor confidence is crucial to the

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success of our economic system. This confidence is threatened by not only the Enron scandal but by the dramatic decline in accounting standards. People increasingly feel the game is rigged. Unless Washington and business professionals seize the moment to clean up the mess in the market economy, they risk a major populist backlash.

In the end, Enron was able to enlist precisely those referees who, in the past, would oversee and check its behavior—accountants, lawyers, bankers, legislators, even regulators—in the pursuit of higher earnings. Many were tempted by a piece of the equity action and compromised their integrity. Enron paid big fees to many of these professionals to help manufacture its earnings, and together they created the mechanisms for evading the financial truth.

Watkins says as much. She talks of partnership deals that temporarily inflate the stock price, allowing execs to cash out options: "It's a bit like robbing the bank in one year and trying to pay it back two years later." She adds, "nice try but investors were hurt" when they bought stock that later fell. In a free-market economy, companies are supposed to fail because of the business cycle or bad business decisions. Failure from loose and sleazy practices, if not outright fraud, is another matter.

We now know that something went seriously wrong in the march to deregulation. There is no question that deregulated markets are generating lower costs, higher growth, and lower unemployment for the U.S. economy. But dereg ideologues, such as Enron's President Jeffrey K. Skilling and the company's political allies in Washington, convinced the nation deregulation meant no regulation. A big mistake. Enron and other companies used the transition to deregulation to gain access to Congress and regulators and write their own rules. They persuaded the Commodity Futures Trading Commission to let Enron and a few other companies run largely unregulated energy-derivatives trading businesses. Wendy Gramm, who at the time was head of the CFTC, later joined Enron's board of directors—on the audit committee.

Financial complexity made it easy to mask the truth and play financial games. The financialization and securitization of the real economy into mathematical bits and bytes allowed Enron and others to massage earnings results in infinite ways. Off-balance-sheeting financial engineering became the requisite way to boost earnings and stock prices. Hundreds of companies have done it (page 36). Common standards were replaced by idiosyncratic measures. Slowly but surely, the financial truth disappeared. No one, not the accountants or lawyers or bankers or Wall Street analysts, protested as the bottom line became a fiction. On the road to deregulation,

Unless the country's leaders seize the moment to clean up the mess, they risk a major populist backlash

lation, basic building blocks of capitalism—clarity, transparency, fairness, openness—were sacrificed. Everytime the public needs to evaluate risk, value stocks, and participate in an equity culture was undermined. America embraced the equity economy in the '90s because we believed they could participate in it fairly. They didn't expect to see their 401(k) up in smoke.

Who can come to the rescue? The reputations of many of the professionals who were counted on to safeguard the economic system lie in tatters. Corrupted by the chase for an ever-greater piece of the action, accountants, lawyers, analysts, and managers have shirked their duty on a scale not seen since the 1920s. Conflicts of interest abound. Accounting firms sell services to the companies they audit. Accountants jump to the corporations whose books they audit. The accounting profession has successfully fought off attempts at reform, rebuffing efforts to end conflicts of interest, impose stricter oversight, or increase liability for their actions. In short, most certified public accountants feel little duty to the public at large.

Nor do lawyers see themselves as officers of the court, which they are. Vinson & Elkins LLP was asked by Enron Chairman Lay to check out whether Watkins' on-page warning of financial deceit warranted a lawsuit.

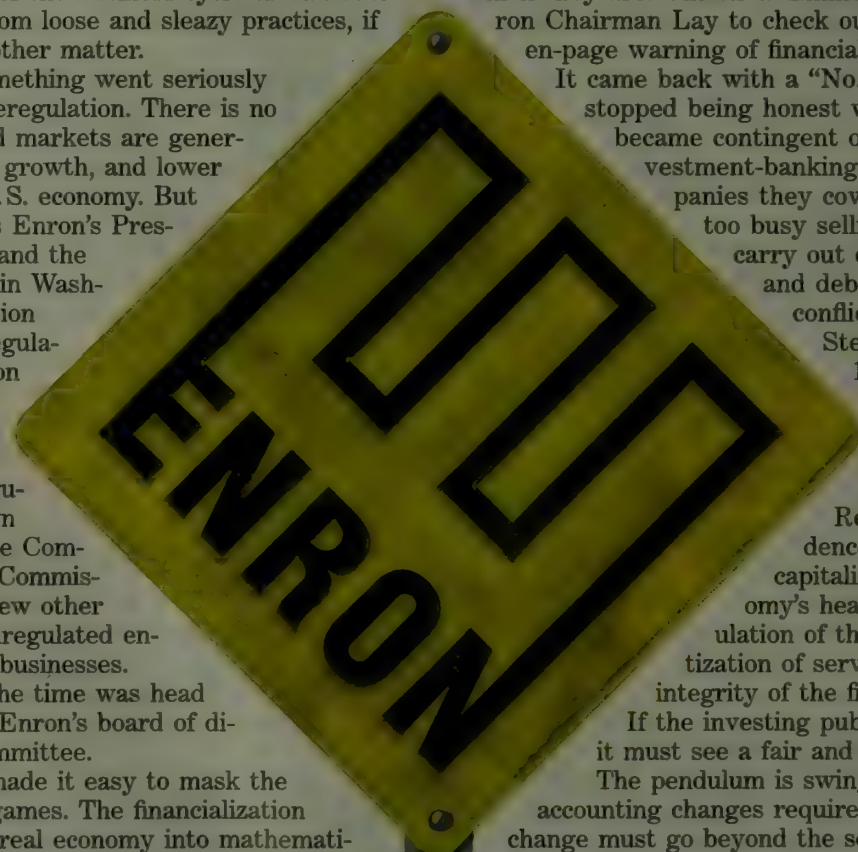
It came back with a "No." Wall Street analysts stopped being honest when their compensation became contingent on their firms getting more investment-banking business from the companies they covered. And bankers got too busy selling fee-based services to carry out due diligence on loans and debt. They have enormous conflicts of interest. The

Steagall Act was passed in 1933 to stop those conflicts. Its repeal in 1996 has ushered in the return.

What's to be done? Restoring investor confidence in the system of capitalism is crucial to the country's health. The continued deregulation of the economy and the privatization of services depends on the integrity of the financial reporting system.

If the investing public is going to participate, it must see a fair and transparent system. The pendulum is swinging toward reform.

The accounting changes required are all too obvious. The change must go beyond the scope of the financial reporting profession. The buying and selling of political access is in the best interests of the country. It is unseemly to have the head of the Justice Dept., as well as the entire Houston branch, recuse themselves because of conflicts on the Enron case. A sense of outrage is growing. The lesson from the Enron debacle should be to restore basic integrity to the bottom line, ethics to business professionals, and clout to overseers that even a deregulated economy need.

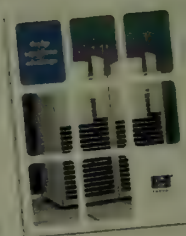


Here are three-hundred-eighty-nine-thousand-four-hundred and thirty-four

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THE WHISTLE-BLOWER

A HERO—AND A SMOKING-GUN LETTER

Watkins' memo spoke volumes about Enron's behavior. So did higher-ups' tepid response

At last, someone in the sordid Enron Corp. scandal seems to have done the right thing. Thanks to whistle-blower Sherron S. Watkins, a no-nonsense Enron vice-president, the scope and audacity of the accounting mess is becoming all too clear. Her blunt Aug. 15 letter to Enron CEO Kenneth L. Lay warns that the company might "implode in a wave of accounting scandals." And now that her worst fears have been realized, it is also clear that Watkins' letter went far beyond highlighting a few accounting problems in a handful of off-balance-sheet partnerships. Watkins' letter lays bare for all to see the underbelly of Enron's get-rich-quick culture.

Watkins, 42, a former Arthur Andersen accountant who remains Enron's vice-president for corporate development, put her finger on the rot: top execs who, at best, appeared to close their eyes to questionable accounting maneuvers; a leadership that had lost sight of ordinary investors and the basic principles of accounting; and watchdogs—the outside auditors and lawyers whose own involvement may have left them too conflicted to query the nature of the deals. Perhaps the question

IN-HOUSE CRITIC

Watkins wondered if Enron was creating income by essentially doing deals with itself

shouldn't be how Enron collapsed so quickly—but why it didn't implode sooner.

Lay's response to Watkins' complaints is nearly as damning as her letter itself. Yes, he talked to her for an hour. And, yes, he ordered an outside investigation. But contrary to Watkins' advice, he appointed the company's longtime Houston law firm, Vinson & Elkins, despite the obvious conflict: V&E had worked on some of the partnerships. And Enron and V&E agreed there would be no "second-guessing" of Andersen's accounting and no "detailed analysis" of each and every transaction, according to V&E's Oct. 15 report. The inquiry was to consider only if there was

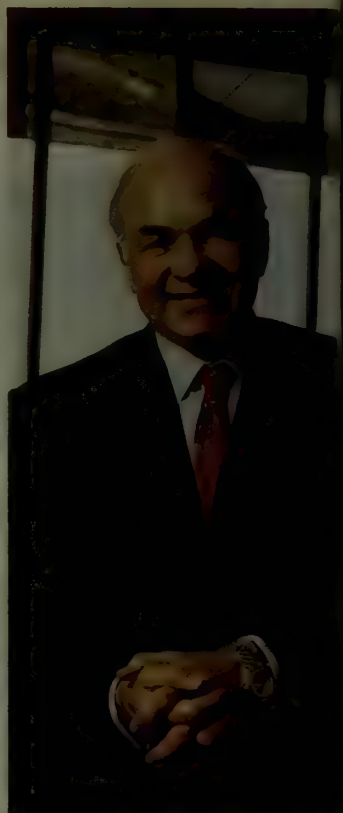
new factual information that warranted a broader investigation. V&E declined comment.

Surprise: V&E concluded that a widespread investigation wasn't warranted. It simply warned that there was a "serious risk of adverse publicity and litigation." And Watkins' letter reveals the inadequacy of Lay's response in the months following CEO Jeffrey K. Skilling's sudden Aug. 14 resignation for "personal reasons." His departure triggered the letter. Lay never fully disclosed the partnerships plained their impact to investors, even as he vowed there were no accounting issues and "no other shoe to fall." after Enron revealed on Oct. 16 a \$1.2 billion hit to

holder equity related to the partnership. Lay continued to express ignorance of details of these deals and support for Financial Officer Andrew S. Fastow managed and had stakes in certain partnerships. But on Oct. 24, Fastow removed from his job and promptly left the company.

Watkins, an eight-year Enron veteran, is not some disgruntled naysayer who is easy to dismiss. Her lawyer, Philip H. [redacted], says she became familiar with some partnership dealings when she worked for Fastow in June and July in Fastow's finance department. Her position allowed her to review the valuation of certain assets being sold in partnerships, and that's when she saw computations that just didn't jibe," says [redacted].

Former executives say the Tomball



Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation problems. Enron's aggressive accounting practices, especially the derivative transactions, are

I am incredibly nervous that we will implode in a wave of accounting scandals. My 8

I realize that we have had a lot of smart people looking at this and a lot of accountants including AA&Co. have blessed the accounting treatment. None of that will protect Enron if these transactions are ever disclosed in the bright light of day. (P) [redacted] the [redacted] problem. Vaste Manager [redacted] paid \$170



native was tenacious and competent. "She wasn't really an alarmist," says one former Enron employee. Her mother, Shirley Klein Harrington, a former high school accounting teacher, calls her daughter "a very independent, outspoken, good Christian girl, who's going to stand up for principle whenever she can." Watkins had previously worked at Andersen in Houston and New York and then for Germany's Metallgesellschaft AG.

At those companies, she befriended Jeffrey McMahon, whom she helped recruit. Now the CFO at Enron, McMahon "complained mightily" about the Fastow partnerships to Skilling. Watkins told Lay in the letter. "Employees question our accounting propriety consistently and constantly," she claimed. McMahon didn't return calls. Skilling has denied getting any warnings about accounting.

Watkins didn't stop. Five days after she wrote to Lay, Watkins took her concerns directly to an Andersen audit partner, according to congressional investigators. He in turn relayed her questions to senior Andersen management on the Enron account. Not known what, if any, action they took.

Of course, Skilling and Andersen execs shouldn't have heeded a letter and a phone call from Watkins to figure something was seriously amiss. Red flags abounded. Watkins, for one, had no trouble putting her finger on questionable accounting practices. She wondered if Enron was hiding losses in off-balance-sheet entities while booking large profits from the deals. At the same time, the outside partnerships were backed with Enron stock—a tactic sure to backfire when it was falling—and no outsiders seemed to have any capital at risk. Was Enron increasing income essentially by doing deals with itself? "It sure is to the layman on the street that we are hiding losses in related company and will compensate that company with Enron stock in the future," she wrote.

In the end, Watkins grasped one thing that Enron's toady-by-half dealmakers didn't: Enron's maneuvering didn't pass the smell test. Even if Enron and its high-priced auditors and lawyers can ultimately show that they followed the letter of the law, it matters little. As Watkins herself wrote, if Enron collapses, "the business world will consider the past successes as nothing but an elaborate accounting hoax." And Enron seems destined to become Enron's epitaph.

By Wendy Zellner, with Stephanie Forest Anderson, in Houston and with Laura Cohn in Washington

THE PERFECT SALES PITCH: NO DEBT, NO WORRIES

At Enron Corp., debt avoidance wasn't merely a strategy for managing its own balance sheet. It was a way of life that pervaded the company's dealmaking culture. Consider Enron Energy Services, which managed energy needs and equipment for big corporate customers. The company held regular seminars to teach EES employees how to use complex financial vehicles to woo customers, manage earnings, and, naturally, keep debt off balance sheets at Enron and its clients. Former Enron executive Michael R. Boutcher recalls a class on structured finance that described the financings as "accounting nirvana"—able to not only get debt off the books but even out of accounting footnotes.

No one is claiming that these structures were akin to the off-balance sheet partnerships at the heart of Enron's accounting scandal. These deals gave tax and other benefits to customers who outsourced their energy management to Enron. But they certainly highlight Enron's aggressive philosophy of leveraging its financial acumen. Boutcher, manager of business development at EES until Enron's December collapse, says that creating complex financings with clients was standard practice. And, he says, Enron used them far more aggressively than its rivals. "We could always sweeten the pot, and the objective was to beat out anybody that was competing against us," says Boutcher. An Enron spokeswoman says such equipment financing was

Structured Finance

Houston
November 9, 2000

Balloon Residual Lease

Some customers are interested in having the capital piece of the outsourcing off-credit.

Off balance sheet: Easily achieved through operating leases. Companies must, however, footnote future operating lease payment obligations.

Off credit: Difficult to achieve. This requires that there is no footnote disclosure at all. Must make it look like the company has no financial obligation at all under any circumstances including default by them.

Off credit: Difficult to achieve. This requires that there is no footnote disclosure at all. Must make it look like the company has no financial obligation at all under any circumstances including default by them.

common in the industry. But several rivals disagree.

In a presentation on Nov. 9, 2000, to some 60 employees in Houston, Boutcher says, a company lawyer explained how structured-finance deals could manage and accelerate earnings for Enron and take debt "off credit" for customers, so that it wouldn't be reflected in credit ratings. The objective laid out in one page of the presentation couldn't have been clearer: "Off credit: Difficult to achieve. ... Must make it look like the company has no financial obligation at all under any circumstances, including default by them."

EES says it never actually did one of the "off-credit" deals. There were some things even Enron couldn't peddle.

By Wendy Zellner in Dallas and Michael Arndt in Chicago

DISCLOSURE

WHO ELSE IS HIDING DEBT

Moving financial obligations into off-book vehicles is now a common ploy

When energy trader Enron Corp. admitted to hiding billions of dollars of liabilities in mysterious off-book entities, it trotted out the lame excuse of scoundrels: Everyone does it. And this time, it was the gospel truth.

Hundreds of respected U.S. companies are ferreting away trillions of dollars in debt in off-balance-sheet subsidiaries, partnerships, and assorted obligations, including leases, pension plans, and take-or-pay contracts with suppliers. Potentially bankrupting contracts are mentioned vaguely in footnotes to company accounts, at best. The goal is to skirt the rules of consolidation, the bedrock of the American financial reporting system and the source of much its credibility. These rules, set clear in 1959, aim to make public companies give a full and fair picture of their business—including all the assets and liabilities of any subsidiaries. But accountants, lawyers, and bankers have learned to drive a coach and horses through them.

Because of a gaping loophole in accounting practice, companies create arcane legal structures, often called special-purpose entities (SPEs). Then, the parent can bankroll up to 97% of the initial investment in an SPE without having to consolidate it into its own accounts. Normally, once a company owns 50% or more of another, it must consolidate it under the 1959 rules. The controversial exception that outsiders need invest only 3% of an SPE's capital for it to be independent and off the balance sheet came about through fumbles by the Securities & Exchange Commission and the Financial Accounting Standards Board. In 1990, accounting firms asked the SEC to endorse the 3% rule that had become a common, though unofficial, practice in the '80s. The SEC didn't like the idea, but it didn't stomp on it, either. It asked the FASB to set tighter rules to force consolidation of entities that were effectively controlled by companies. FASB drafted two overhauls of the rules but never finished the job, and the SEC is still waiting.

It's not just the energy industry that exploits the loophole and stashes major liabilities in the never-never land of SPEs. Increasingly, companies of all stripes routinely use them to offload potential balance-sheet bombshells such as loan guarantees or the financing of sales of their own products. For example, the accounts of data processor Electronic Data Systems Corp. don't show \$500 mil-

lion—half of last year's earnings—that it would owe if its customers were to cancel their contracts and leave it holding the bag for loans on their computer equipment. The arrangement is acknowledged only in a footnote. An EDS spokesman says the tactic is common in the industry and does not put the company at undue risk.

Airlines keep appearances aloft by shunting billions worth of airplane financing into off-balance-sheet vehicles, says credit analyst Philip Baggaley of Standard & Poor's Corp. United Airlines Inc. parent UAL Corp.'s published balance sheet for 2000 shows \$5 billion of long-term debt. But only a footnote describes the bulk of its lease payments, which Baggaley estimates have a present value of \$12.7 billion, due over 26 years on 233 airplanes. AMR Corp., parent of American Airlines Inc., is on the hook for \$7.9 billion in lease payments not on its balance sheet. "Everyone who's involved in the industry knows that the true leverage is higher" than shown on the balance sheet, says Baggaley. UAL and AMR declined to comment.

Banks arrange many of the devices and are big themselves. J.P. Morgan Chase & Co., for example, has revealed in the Enron bankruptcy that it has nearly \$1 billion in potential liabilities stemming from a single 49%-owned Channel Islands entity called Mahonia that traded with Enron

liabilities bring the bank's total Enron exposure to \$2.6 billion. And J.P. Morgan is not alone. A suit filed earlier this month shows that many U.S. finance companies are among 52 partners in LJM2, an Enron off-balance-sheet entity with over \$1 billion in assets. The partners, including Citigroup, Citicorp, and American International Group, may all be taking losses on it.

The banks' participation in SPEs is attracting scrutiny from federal regulators. A Federal Reserve spokesman said he was "concerned about" off-balance-sheet exposures and the new accounting rules w-

OUT OF SIGHT

Many companies keep debts and other obligations out of investors' view in partnerships and other entities. Often, financial liabilities are secured by physical assets such as planes or computers. A sample:

COMPANY	ITEM NOT ON BALANCE SHEET	ESTIMATED EXPOSURE BILLIONS
UAL	Plane leases	\$12.7
AMR	Plane leases	7.9
J.P. MORGAN CHASE	Liability for trading units	1.0*
DELL COMPUTER	Debt of consumer financing venture	N/A**
ELECTRONIC DATA SYSTEMS	Payments for customers' computers	0.5

*Exposure to Enron through Mahonia

**Joint venture partner Tyco Intl. is responsible for losses

Data: Standard & Poor's, company reports



what. For example, Dell Computer Corp. has a joint venture with Tyco International Ltd. called Dell Financial Services that last year originated \$2.5 billion in customer financing, according to a footnote to Dell's accounts. According to the note, Dell owns 70% of DFS, but does not control it and therefore keeps DFS debts off its own balance sheet. What if DFS has trouble from customers not paying? Dell spokesman T.R. Reid says any obligations of DFS are Tyco's responsibility and Tyco agrees. Jeffrey D. Simon, president of the global vendor financing business at Tyco Capital, says Tyco would look to Dell's customers to pay and not to Dell. Tyco's balance sheet reflects borrowing to finance Dell's customers.

Companies argue that off-balance sheet vehicles benefit investors because they enable management to tap extra sources of financing and hedge trading risks that could roil earnings. Maybe so, but they sure make the companies, and their executives, look good: Return on capital looks better than it is because balance sheets understate the amount employed. And investors and regulators don't freak out as corporate debt balloons. But critics charge that the widespread use of off-balance-sheet schemes encourages contempt for accounting rules in the executive suite and spreads confusion among investors. "The nonprofessional has no idea of the extent of the real liabilities," says J. Edward Ketzer, accounting professor at Pennsylvania State

University. "Professionals can be easily fooled, too."

Worse yet, many SPES have provisions that can throw their users into a full-blown financial crisis. To get assets off its books, a company typically sells them to an SPE, funding the purchase by borrowing cash from institutional investors. As a sweetener to protect investors, many SPES incorporate triggers that require the parent to repay loans or give them new securities if its stock falls below a certain price or credit-rating agencies downgrade its debt. It was just such triggers in its notorious off-balance-sheet partnerships that sent Enron into a death spiral. And triggers fueled the crises last year at Pacific Gas & Electric, Southern California Edison, and Xerox, according to Moody's Investors Service. "All of this hidden debt and these triggers could make the next economic downturn a lot worse than it would otherwise be," says Lynn Turner, who was chief accountant at the Securities & Exchange Commission until July.

Despite the risks, SPES remain very appealing to companies. And any attempt to curb them or abolish the 3% rule will run into furious opposition. Since the early '90s, an army of accountants, lawyers, and bankers built a huge industry to concoct ever more creative ways to evade consolidated reporting. So reform won't come easily. "It will be a phenomenal fight," says Turner.

Maybe so, but Enron's demise shows how quickly a tiny loophole can tear the country's economic fabric. And there may never be a better time to close it.

By David Henry, with Heather Timmons and Steve Rosenbush in New York and Michael Arndt in Chicago

in place. How many more Mahonia or LJM2-like entities are there? The Channel Islands tax haven boasts more than 350 and similar entities, though it is impossible to know how many should really be consolidated on balance sheets of companies. Assets in the entities total more than \$635 billion, according to Fitzrovia International PLC, a London-based research firm. The Cayman Islands, which has been competing for the business since the 1980s, claims another 600 trusts and funds, most of which have SPE expertise. With some of the vehicles, it is impossible for investors to get the truth from financial reports who could be responsible for

THE LAWYERS

ONE BIG CLIENT, ONE BIG HASSLE

Vinson & Elkins' heavy reliance on Enron is now a potential liability for the law firm

Aftershocks from the collapse of Enron Corp. have rocked the energy giant's auditors, bankers—and now its attorneys. Houston law firm Vinson & Elkins was the latest to be hit when news broke that it had shrugged off allegations of accounting fraud by whistle-blower Sherron S. Watkins. That's an incendiary revelation, for certain. But it may not pose nearly as much of a threat to Vinson & Elkins as some of the other work the firm may have done for Enron—namely, helping to construct the web of partnerships the company used to move debt off the balance sheet and providing advice on what executives should disclose to the Securities & Exchange Commission.

Why are these activities such a big potential problem? Under the law, it is hard to pin the blame on lawyers for financial fiascos. They would have had to play a role nearly equal to that of the primary perpetrators. Most experts agree that V&E's seemingly dismissive attitude about the Watkins allegations—months after the transactions she complained about took place—probably does not meet the standard for either criminal or civil liability. But that verdict might be different if it turns out that the firm's attorneys also helped Enron devise some of the complex deals that wound up sinking the company in the first place.

There are growing indications that may just be the case. In her missive to Enron Chairman and CEO Kenneth L. Lay, Watkins suggested that the law firm wrote so-called opinion letters vouching for the legality of some of the deals now under scrutiny. And according to two ex-Enron executives contacted by *BusinessWeek*, Vinson & Elkins played a creative role in structuring and managing some of the company's controversial "special purpose" partnerships. One former executive in the company's Houston office says employees would approach Vinson & Elkins lawyers "and say, 'this thing needs to work. How do we make it work?'" This source adds that the firm also gave Enron advice on how



HOUSTON OFFICES

The venerable Texas law firm may have helped Enron execute some of the company's more questionable deals

much information it had to disclose about its financial negotiations in its 10K and 10Q reports to the SEC.

Legally speaking, the key issue will be whether Vinson & Elkins blessed activities that it knew to be fraudulent. "It could be in trouble, says University of Illinois law professor Ronald D. Rotunda, an expert in legal ethics. "Under the fact scenarios, they could have real problems," says Rotunda.

The law firm denies that it has done anything wrong. Cause Vinson & Elkins' conduct is under federal scrutiny. Managing Partner Joseph Dilg declined to discuss the investigation of the letter written by Watkins and was willing to offer a few details about the firm's other work for Enron. He said the law firm's professional responsibility

committee reviewed its work for Enron in October and November and found no improprieties. "Everything that the firm's lawyers who have represented Enron have done has been [accomplished] in a completely professional, competent and ethical manner," says Dilg, who is also a key contact on the Enron account.

He and fellow partners undoubtedly find themselves called upon to prove their point. Enron and V&E have enjoyed one of the closest lawyer-client relationships in Corporate America. Both Enron's general counsel, James V. Derrick Jr., and his top tenant, deputy general counsel Robert H. Walls Jr., were former partners at the firm. An additional 20 o

TWO-WAY CONNECTION

ENRON TIES

The energy giant has long been Vinson & Elkins' top client. Last year, it accounted for



DERRICK

more than 7% of V&E's \$450 million in revenue. Managing Partner Joseph Dilg is a key contact for the Enron account. Enron's general counsel, James V. Derrick Jr., is a former V&E partner. Several other members of the legal department also hail from Vinson & Elkins.



DILG

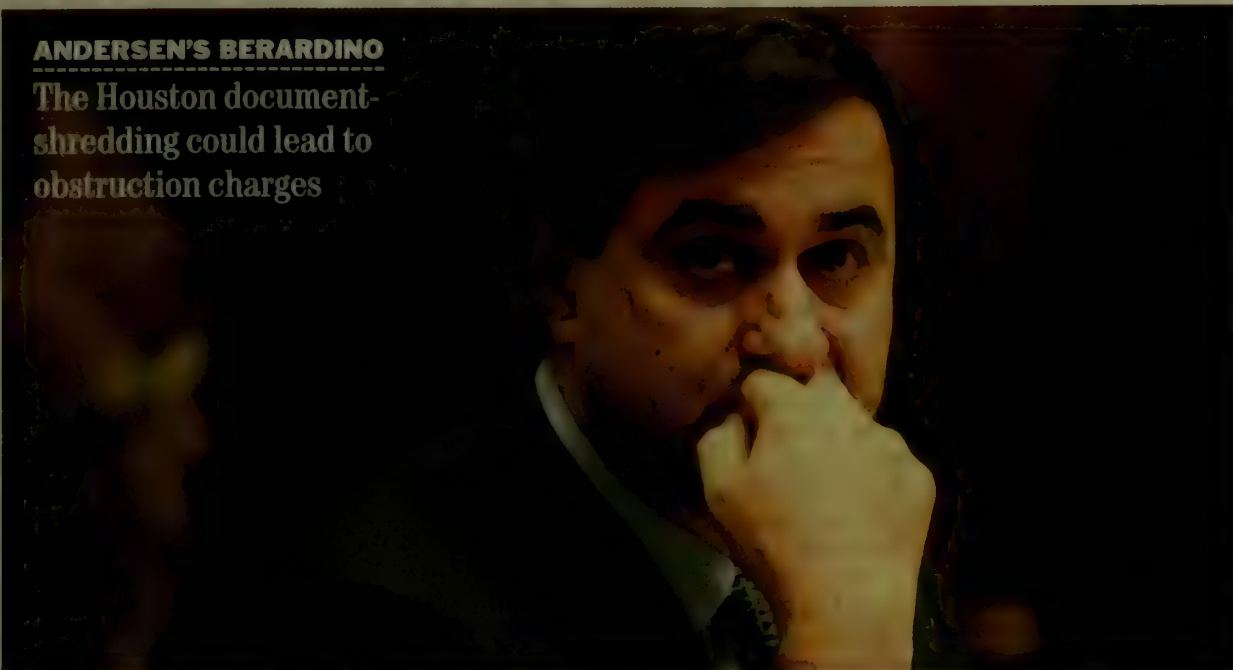
PRESIDENTIAL TIES

V&E gave the Bush campaign \$190,000, making the firm his second-largest donor. White House Counsel Alberto Gonzales is a former partner in V&E's corporate department.

Data: BusinessWeek, American Lawyer

ANDERSEN'S BERARDINO

The Houston document-shredding could lead to obstruction charges



attorneys have taken jobs at Enron's legal department the past decade, Dilg estimates. And Enron is V&E's single largest customer. In 2001, Enron accounted for more than 7% of V&E's \$450 million in revenue. The law firm had several lawyers working virtually full-time on company business, including some permanently stationed in its offices. By contrast, Enron contributed less than 1% to auditor Arthur Andersen's revenues.

The exact details of Vinson & Elkins work for Enron are still murky. In her letter, Watkins claimed that the firm "provided true sale opinions on some of the deals" related to the so-called Condor and Raptor deals. She could not be reached for clarification. According to one New York corporate finance attorney, true sale opinions are letters that law firms write certifying for the fact that business transactions meet particular legal requirements. So, for example, they might certify that title was passed in a particular deal or that it was conducted between two legally independent parties. Such documents would have been important to Enron, since many of its deals took place with partnerships in which it held a large stake. V&E declined to discuss the opinion letters.

True sale opinions in the energy sector are always requested by auditors before they are willing to sign off on the accounting treatment for a particular deal, according to finance attorneys. They are also requested by rating agencies, which seek to assure lenders that both of the participants in a particular related-party transaction would be treated independently in the event one of them went bankrupt. Otherwise, one party could be left unfairly holding the bag for the failure of a company or partnership with which it has no ties.

According to one former Enron employee, the company did not have been able to pull off many of the transactions under investigation without Vinson & Elkins' opinion letters. The company "opinion-shopped for what it needed," this source. "If it hadn't gotten the opinion letters, it wouldn't have done the deals."

Accusations by embittered ex-employees obviously have to be taken with a grain of salt. There's still little hard evidence about what Vinson & Elkins did or didn't do for Enron. But if the firm turns out to have worked hand in hand with top management, it could be finding itself in the same hot water as the energy giant's auditors and bankers.

by Mike France in New York, with Wendy Zellner in Houston and Christopher Palmeri in Los Angeles

THE ACCOUNTANTS

CAN ANDERSEN SURVIVE?

Keeping the firm alive through the probes and lawsuits will be a monumental job

For partners and professionals in Arthur Andersen's Houston office, there was one sure way to move up: Figure out new ways to make Enron Corp. happy. More than 100 staffers were devoted to the office's largest account, which by Enron's calculation was worth more than \$50 million a year.

Perhaps it was inevitable, then, that as the energy-trading giant rose to prominence in the '90s, Andersen's green-eyeshade legions came to bask in Enron's glow. If a top partner in the Houston office got a call from ex-Enron CEO Jeffrey K. Skilling, it "made his day," says an ex-Andersen exec. Enron only enhanced Andersen's reputation as the leading auditing firm for the oil-and-gas business. "They were the best. They were always viewed as the firm to go to in Houston," says Stephen D. Newton, managing director at executive recruiter Russell Reynolds Associates Inc. A client-service team working out of Andersen's marketing department met regularly with David B. Duncan, the lead partner on the Enron account, to figure out what new tax advice or risk-management product they could sell to the energy giant. Several top Enron execs, including its chief accounting officer, had come from Andersen. Andersen even cut a deal to handle some of the "internal" auditing work for Enron along with vetting its public reports for the trading firm's audit committee.

It is now clear that Andersen will pay dearly for that chum-

my relationship. Its Houston office is at the center of a growing scandal that could cost Andersen and its partners billions and, ultimately, may lead to the demise of the firm. On Jan. 15, Andersen dismissed Duncan for directing what it describes as a frantic two-week effort to destroy "thousands" of e-mail messages and documents related to its audit of Enron. It also put three Houston partners on leave and relieved four others, including D. Stephen Goddard Jr., managing partner who ran the Houston office, of management responsibilities. "This was a painful decision, but it was absolutely the right thing to do," said Andersen CEO Joseph F. Berardino in a statement. "We are prepared to take all appropriate steps necessary to maintain confidence in the integrity of our firm." An attorney for Duncan did not return phone calls. And Goddard could not be reached.



But will those moves be enough? Berardino faces the real prospect that daily revelations about Andersen's involvement in the accounting scandal have permanently damaged its reputation—and could eventually lead to criminal charges, such as obstruction of justice. From his statements about the firing of Duncan and other steps taken in Houston, it's clear that Berardino would like to contain the damage to that office. But investigators are looking closely at broader questions involving Andersen's role in Enron's collapse. For instance, what did Andersen know about the problems with off-balance-sheet partnerships that inflated Enron's income? Congressional investigators say that in addition to warning Enron Chairman and CEO Kenneth L. Lay about that accounting in a memo last August, Enron executive Sheron S. Watkins also followed up with a phone call to an Andersen partner.

Already, some talent is trying to jump ship: A Houston-area headhunter says his firm has gotten 1,000 resumé from top Andersen people in one week. Some industry observers figure that Andersen's fall, perhaps through a sale or merger, could come within a year. For Andersen to survive, says professional-services consultant Dean McMann, "they'd really have to land some very large accounts in a market where accounts don't change very often." Losing accounts is also possible. Already, the audit committee at one longtime client, R.R. Donnelley & Sons Co., is planning to review its use of the firm.

Other energy companies will be watching closely as the drama plays out. While it is the smallest of the Big Five, Andersen dominated in Houston. Long before Enron, the firm was known as a pioneer for innovations such as a way to expense dry holes over the life of an oil field, says I.T. "Tex" Corley, an ex-Andersen partner who now runs a glass-recycling business. Every year, Andersen hosts Houston's premier energy conference at a glitzy hotel, bringing in foreign oil ministers, Washington officials, and top executives. It had 70% of the city's oil-and-gas clients, says a former exec.

Holding Andersen together through the storm will be a monumental job. The firm is already the big-pockets defendant

The head of the Houston office lost his management responsibility, and the lead Enron partner was fired

STEPHEN GODDARD RAN THE HOUSTON OFFICE

in some 40 shareholder lawsuits in which plaintiffs' lawyers claiming damages of more than \$32 billion. Enron, the primary defendant, is all but immune to the actions because of its bankruptcy filing. Bill Lerach, managing partner at Milberg Weiss Bershad Hynes & Lerach LLP, a firm handling one of the shareholder suits, says: "I don't think you ever want to take large entities go out of business because of litigation, but clients have to be appropriately compensated for what happened here."

Fighting the legal battles—along with struggling with fewer than eight separate congressional probes—is bound to take a heavy toll on Berardino and many of his 3,000 partners. If they decide to settle the lawsuits, it will cost them dearly. Almost certainly more than the \$110 million they paid to settle shareholder litigation in the liquidation of Sunbeam Corp. or their unspecified share of a \$220 million settlement of the earlier Waste Management Inc. case. Andersen won't say how much insurance it has, but another settlement of hundreds of millions of dollars could be devastating. And if fraud is found, much of the cost won't be covered.

Of course, Andersen's fate will turn on how culpable

proves to be in the collapse of Enron. Until mid-January, Berardino had admitted that his firm made only one professional misjudgment in auditing Enron, which, he says, accounts for a relatively small part of Enron's earnings restatements. And he says, the firm was not aware of certain crucial information about another Enron partnership that was auditing, which also led to restatements. But revelations of document destruction prove far more damning. Justice Dept. investigators doubt that they amount to obstruction of justice. And Watkins' warning raises questions

QUESTIONS FOR ANDERSEN

The firm's survival may hinge on the answers investigators get on some crucial issues:

- What role did Andersen's Houston office play in creating off-balance-sheet partnerships that inflated Enron's income?
- Did Andersen's Chicago headquarters sign off on those partnerships? Was it aware of the questions raised about the partnership accounting?
- Was anyone at Andersen headquarters—or Enron—involved in the decision to destroy documents?
- Did Andersen's multimillion-dollar consulting contract with Enron color its auditing judgment?

whether Andersen had a more active role in setting up off-balance partnerships than it has conceded.

Comparisons have arisen between Andersen's woes and the fall of Laventhol & Horwath in 1990. Although far smaller, L&H faced a rash of shareholder lawsuits over problematic audits, a nasty client bankruptcy, and a loss of confidence. The L&H partners, suffering multimillion-dollar legal settlements, agreed to dissolve. "The partners just wanted to get away from the pain," recalls ex-L&H CEO Robert N. Levine, now a consultant in Mill Valley, Calif. Unless Berardino can reassure shareholders, and a slew of investigators that Enron was an isolated affair in which Andersen played a bit part, he may find himself in a similar spot.

By Joseph Weber in Chicago, with Christopher Palmieri in Los Angeles, Louis Lavelle and Nanette Byrnes in New York, and Wendy Zellner in Dallas

COMMENTARY

By Howard Gleckman

THERE'S NO POSITIVE SPIN ON THIS ONE, MR. LINDSEY



OUTTA LUCK: And out of the loop

Even after three decades in Washington, I occasionally hear something so stunningly wrongheaded that it takes my breath away. That's what happened on Jan. 6, when White House economic adviser Lawrence B. Lindsey called the Enron collapse a "tribute to American capitalism." And all this time I thought of the demise of what was once the seventh-biggest company in the nation as a massive failure of our modern market economy.

For Lindsey, the great achievement of Enron's fall was that the government let it happen, despite the company's political connections. That's true as it goes. And it is nice to know that the U.S. isn't, say, Argentina, where a severe case of free-market capitalism helped bring down the economy.

But Enron fell so far so fast that there was nothing its political patrons could do. Once it became clear that the company had repeatedly misstated its earnings and, most important, that its employees' 401(k) investments had evaporated, Enron became radioactive. The time Chairman Kenneth L. Lay and top Administration officials in October, their response was preordained. The man President George W. Bush used to call "Kenny Boy" wasn't going to get any help, despite years of campaign contributions. Lindsey may find it praiseworthy that Washington didn't throw together

a last-minute bailout of Enron, but he ignores all that happened before Lay made his phone calls.

You can start in the '90s. That's when the Commodity Futures Trading Commission decided to let Enron and a handful of other companies run largely unregulated energy-trading businesses. Then, two years ago, Enron used its political clout to get Congress to exempt it from both CFTC and Securities & Exchange Commission regulation of what had become, in essence, a publicly traded hedge fund making its own highly speculative investments.

And, of course, there were the company's internal dealings.



ENRON'S FAILURE **“**is a tribute to American capitalism**”**

—LAWRENCE B. LINDSEY, White House economic adviser

For at least four years, Enron misrepresented its earnings by \$400 million or more. Top managers were selling chunks of company stock even as its employees were barred from doing so. And Enron's outside directors, the people charged with the responsibility to protect shareholders from the mistakes or avarice of management, seemed to have missed it all.

Capitalism works only when it is played on a level field. The essence of efficient markets, as Lindsey knows

better than I, is transparency—the ability of every shareholder to know, more or less, what every other shareholder knows.

But modern American capitalism failed the owners of Enron. Not because the company failed—a basic tenet of capitalism is the freedom to succeed or flop. Rather, it failed because Enron management and its auditor, Arthur Andersen, didn't play by the rules that define a market economy. And they were allowed to get away with it for years.

The great tragedy is that if the system had worked as it should have, Enron would still be in business. Oh, it never would have seen its share price run up to \$90. But neither would it have collapsed.

Had Andersen blown the whistle on shaky financial transactions early on, Enron would have been forced to keep its debt from spiraling out of control. Had its outside directors actually represented shareholders and demanded that management stop playing games with its books, Enron would be viable today. Had the government regulated Enron in the same way as other commodity exchanges, it would never have run up the liabilities it did.

In short, Enron would be a thriving—though retrenched—energy trading company instead of a carcass left to be picked over by government investigators and tort lawyers. Thousands of employees would still have

their jobs. Their 401(k) plans would still have considerable value. And millions of investors would happily own a solid, if unspectacular, stock.

No one would ever have noticed if the auditors, outside directors, and regulators had done the right thing. It all would just have worked the way it was supposed to—and that would have been the real tribute to capitalism.

Gleckman covers economic policy from Washington.

WASHINGTON

THE FALLOUT FOR BUSH AND CONGRESS

How the Enron disaster will color a string of policy debates

The financial debacle that is Enron Corp. shows no early signs of developing into a cancer-on-the-Presidency crisis like scandals of the past. Absent proof of White House favors for the ill-fated energy company, nobody in the Bush Administration seems likely to be bounced out of office or become a political scapegoat—at least not yet. Indeed, the President blithely dismisses potential political fallout from Enron—instead joking about terrorist pretzels and traipsing around the Heartland touting trade liberalization. And there's some reason for his optimism. "There has to be a smoking gun for this to become an issue" for Bush, says University of Texas political scientist Bruce Buchanan.

But while the Administration seems to have deflected much of the political heat from the 13 Enron inquiries already under way, the corporate scandal seems destined to leave a mark on Bush's Washington. Already, the issues raised by the biggest bankruptcy in American history have altered the 2002 policy debate, from campaign-finance reform to energy, and have caused a fundamental rethinking of the role of federal regulators.

One major reason for the seismic shift in capital attitudes is Enron's high profile in politics. The corporation and its executives contributed almost \$5.8 million to political war chests since 1989, including \$1.9 million in soft money to both parties. While 73% went to Republicans, including President Bush—whose campaign and inauguration committee received \$424,000—Enron also donated to prominent Democrats, such as House Minority Leader Dick Gephardt (Mo.), Senate Energy Committee Chairman Jeff Bingaman (N.M.), and Senator Chuck Schumer (N.Y.).

From the days of the first President Bush, Enron was a case study in how to play the Washington game effectively. It got into the wholesale electricity business in part because it successfully pushed legislation in 1992 that allowed it to do so. It managed to keep regulators away from its far-flung trading business over the past decade and has always had a seat at the table when energy legislation was considered. In 1996, Enron donated \$100,000 in soft money to the Democratic Party after the Clinton White House helped with troubled negotiations over a power plant in India.

Besides spreading money around, how did Enron amass such clout? CEO Kenneth L. Lay's capital connections date back to the Nixon Administration, when he was an adviser to the Federal Energy Regulatory Commission and the Interior Dept. official dealing with energy issues. Close personal relationships between Lay and both Presidents Bush helped, as did a compelling story line as an innovative company. Indeed, Democrats from Clinton to former Texas Governor Ann Richards sought out Lay for advice, counsel and contributions. In the end, former friends on Ca



"We spent the last 10 years breaking down walls between

Hill felt betrayed and deceived by the alleged corporate misconduct that cost thousands of workers their jobs and many their retirement savings. The backlash could have profound consequences. Here's how:

RETHINKING DEREGULATION

■ While the Administration prepares to launch a year-long assault on federal regs that it believes are stifling economic growth, some lawmakers think the unshackling of industries is coming to an end. "We spent the last 10 years breaking down walls between businesses," says Representative Joe Barton (R-Tex.). "I think that's over." Even some longtime deregulation advocates are rethinking the role of federal watchdogs. "A whole lot of little people got hurt because someone wasn't watching out for them," says Representative Charles W. Stenholm (D-Tex.), a leading Democratic conservative.

Office of Management & Budget Director Mitch Daniels calls Enron "a very graphic example of what can happen when we don't have enough transparency in the marketplace. It may well eventually lead to further federal action." One probable reform: a change in accounting rules that, at a minimum, would forbid accountants who audit a company from contact with their consultant colleagues who advise the same company's managers about how to increase profits. Also likely are regs that restrict companies that use their stock to match employee contributions to 401(k) accounts. In fact, a cap may be placed on the percentage of company stock permitted in such accounts.

REVIVING CAMPAIGN REFORM

■ The harsh spotlight on Enron has exposed how big contributors buy access with generous donations. Supporters of the stalled McCain-Feingold campaign-finance-reform bill are hoping the scandal generates the momentum needed to ban soft money and broaden disclosure requirements. "Enron is a story about big dollars that influence public decisions," says Representative Christopher Shays (R-Conn.), a reform leader.

While the campaign-finance overhaul passed the Senate last year, it stalled in the GOP House. Reformers are hoping that the anti-Enron backlash will help them get the two additional signatures needed to force a showdown vote on the House floor. Still, even if Shays & Co. win in the House, reform opponents, led by House Majority Whip Tom DeLay (R-Tex.), will try to scuttle the proposal in a House-Senate conference committee. (DeLay has received \$28,000 in Enron contributions since 1988, placing him fourth among House members who got gifts from the company.) Nonetheless, the long-stalled bill seems to have new life. Because of Enron, "campaign-finance reform is back, alive and kicking," says a Republican consultant Scott W. Reed.

A RENEWED EMPHASIS ON ETHICS

■ The Administration has thus far avoided the ethics problems that dogged the Clintonites. But Enron's financial ties to the Bush team have refocused attention on potential conflicts of interest in the White House—even though there's no evidence that any official intervened when the company was in free fall. Among top Bush aides, chief economic adviser Lawrence B. Lindsey and U.S. Trade Rep Robert B. Zoellick served on an Enron advisory board, and new Republican National Committee Chairman Marc Racicot lobbied for Enron in 2001.

Most problematic for the White House is Enron's involvement in Vice-President Dick Cheney's energy task force last year. Cheney has acknowledged that he and aides met with Enron officials six times while they were formulating the Administration's energy policy. Democrats, hungry for an issue in the 2002 midterm elections, allege that Enron's close ties to the Bushies bought special access to the corridors of power. In fact, a Jan. 11-14 Gallup Poll finds that 46% of Americans believe the Administration did something illegal or unethical. So the pressure is on the White House to shed light on the inner workings of the secretive Cheney group. The General Accounting Office will soon file a lawsuit to force release of the minutes of the task force meetings, *BusinessWeek* has learned.

REVISITING ENERGY POLICY

■ Lawmakers and lobbyists alike believe that a bipartisan compromise is near on legislation. But the attention on Enron could alter the equation on Capitol Hill. For one thing, it's now highly doubtful that the electricity deregulation sought by Enron—and previously backed by House Republicans and Senate Dems—will be included in the final package. And it's less likely that Congress will agree to Bush's proposal to drill in the Arctic National Wildlife Refuge. The Enron fallout "will have a negative impact on the Administration's push for [pro-production] energy legislation," concedes one business lobbyist with close ties to the White House.

MAIN STREET VS. WALL STREET

■ Democrats are preparing to use the Enron scandal as a case study in how Republicans allow powerful corporations to run amok while workers suffer the consequences. Indeed, Gallup found that 63% of Americans believe that Big Business has too much influence over the Administration. But with dozens of Democrats also benefiting from Enron's largesse, that line may be difficult to sell. Certainly, the Enron debacle has fired up GOP populists who have long lamented the clout of Big Business. "Republicans need to deemphasize some of the corporate tax cuts and focus more on individual reductions," says Cato Institute economist Stephen Moore.

While the corporation-bashing rages, the White House remains in damage-control mode. "If the Administration will be disciplined and just answer the [committees'] questions, sooner or later, it goes away," says GOP operative Charles Black. That may be true as far as any whiff of scandal is concerned. But public policy will be formulated in the shadow of the Enron scandal for a long time to come.

By Richard S. Dunham, Lee Walczak, and Dan Carney, with Lorraine Woellert and Laura Cohn, in Washington

nesses. I think that's over"

ACCOUNTING IN CRISIS

Reform is urgent. Here's
what needs to be done

A few years ago, it would hardly have seemed possible: The nation's attention, from the halls of Congress to main street, has been riveted on an accounting scandal, a subject so abstruse it rarely makes the front page. But as the tawdry chapters in the Enron fiasco unfold like some penny dreadful, with explosive revelations of hidden partnerships, shredded documents, and shocking conflicts of interest, it's clear that the fall of Houston-based Enron is in a class by itself.

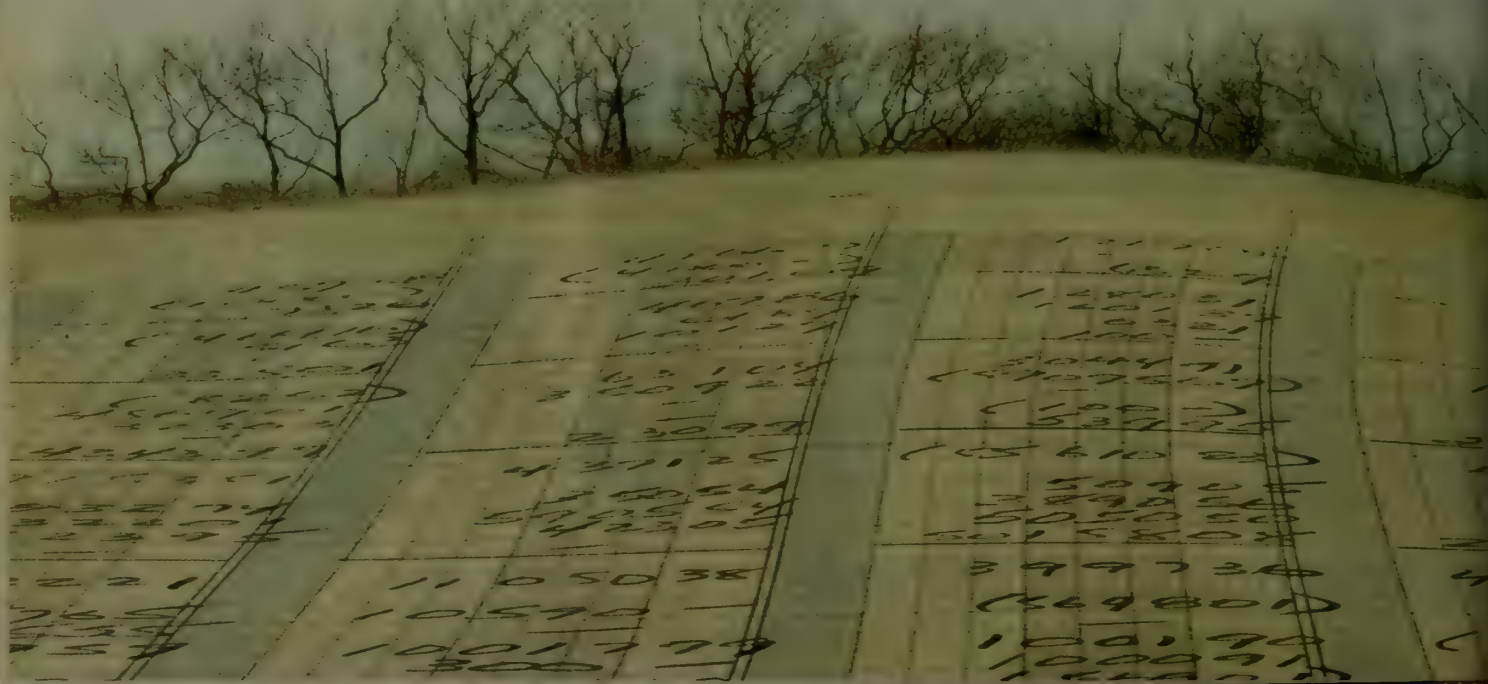
Everything about this debacle is huge: a \$50 billion bankruptcy, \$32 billion lost in market cap, and employee retirement accounts drained of more than \$1 billion. The lapses and conflicts on the part of Enron's auditor Arthur Andersen are equally glaring. Andersen had been Enron's outside auditor since the 1980s, but in the mid-1990s, the firm was given another assignment: to conduct Enron's internal audits as well. In effect, the firm was working on the accounting systems and controls with one hand and attesting to the numbers they produced with the other. And the ties went even deeper: Enron's own in-house financial team was dominated by former Andersen partners. Then, as the firm began its last,

rapid plunge toward bankruptcy, the Andersen auditors frantically tossing records of their work into the shredder.

For working both sides of the street, Andersen was rewarded richly. In 2000, the firm earned \$25 million in fees from Enron, and another \$27 million in consulting and other work. Sure, it's possible that Andersen's auditors blocked all of those connections from their minds and aged still to render an objective opinion, but even formersiders wonder how. "There were so many people in the Houston office who had their finger in the Enron pie," a former Andersen staffer says. "If they had somebody say we can't sign this audit, that person would get fired."

As shocking as Enron is, it's only the latest in a dizzy succession of accounting meltdowns, from Waste Management to Cendant. Lynn E. Turner, former chief accountant of the SEC and now a professor at Colorado State University, calculates that in the past half-dozen years investors have lost close to \$200 billion in earnings restatements and lost market capitalization following audit failures. And the pace seems to be accelerating. Between 1997 and 2000, the number of audit statements doubled, from 116 to 233.

That sorry record has cast doubt on a once honored profession. Auditors have always been in the uncomfortable position of having to judge the financial integrity of the companies that pay them. But in the fast-moving 1990s, intensifying pressure to produce ever rising earnings



prices, Corporate America began to push the accounting daries like never before. And auditors were thrust into a role of enabler. "They began to emphasize too much, be a business partner" to the company, laments Phil Livon, president of the Financial Executives Institute. The accounting industry, which largely regulates itself, steadfastly resisted change, even in the face of repeated failures and scandals. That's about to change. The size scope of the Enron disaster is simply too huge to ignore. Congressional committees are investigating or plan hearings on the matter, and legislation is already in works to force firms to abandon consulting to audit as or face much stiffer legal liability. Securities & Exchange Commissioner Harvey L. Pitt, who himself has led for the Big Five, is shaping a proposal for a new body would remove discipline and investigation of audit fail from the current system of professional peer review. Representative John D. Dingell (D-Mich.), the ranking Democrat on the House Energy & Commerce Committee the hearings begin in early February: "How to make accountants do their jobs will be one of our big interests."

Even after the flameout of Enron, the Big Five accounting firms have yet to acknowledge the need for fundamental change to their independence rules. Instead, in a joint statement issued on Dec. 4, the CEOs of the Big Five focused only on improving the rules of accountancy. Industry leader James S. Turley, chairman of Ernst & Young, says rather than an audit failure, Enron "at its core was a business failure." The American Institute of Certified Public Accountants (AICPA) as well as the other big firms declined to comment for this story.

It's hard not to assign blame to the industry's decades-old system of peer review that again proved its ineffectiveness on Jan. 3. That's when Andersen announced that the firm and its Houston office had successfully passed the review conducted by fellow Big Five firm Deloitte & Touche. Amazingly, two weeks later on Jan. 17, Andersen fired the Houston audit team and put more than 100 Houston partners on leave. "What does this mean," says

University of Illinois accounting professor Andrew D. Bailey Jr., "is that there's another Enron coming around the bend."

To critics, there is a basic disconnect between the Big Five and the broader public outrage. "The whole culture of auditing is based on disclosure, yet the practices of the industry have defied this in recent years by embracing a fortress mentality," says former SEC commissioner Arthur Levitt Jr. who battled in 2000 very publicly with the industry over his proposal to limit consulting.

Whatever shape the final reforms take, they must reach to the heart of the conflicts that have damaged the auditing profession. As the debate begins, here are seven proposals that could go a long way to re-establishing the public trust:

ENACT SELF-REGULATION WITH TEETH

1 The Enron disaster has awakened investors to the accounting crisis. Roger C. Hamilton, a portfolio manager at John Hancock Value Funds, managed to unload his 600,000 Enron shares at \$14 to \$15 last fall before the stock totally collapsed, but he still suffered a substantial loss. Now Hamilton's joining the call for government oversight of the profession: "Then, I think, they would have to play by the rules of the game."

Under the current system of self-policing, it's difficult to figure out who's even in charge. Administered by the AICPA, an industry trade group, is a series of groups that are supposed to monitor auditor independence and audit quality. The Public Oversight

Board (POB) is charged with ensuring that the public interest is considered in the oversight of auditors. But the POB relies entirely

on the CPA firms for its funding and has no authority to investigate, no subpoena power, and no power to punish infractions. An offshoot, the Quality Con-

The industry has strenuously resisted calls for change, even in the face of repeated audit failures



"The accounting profession is very creative at taking

trol Inquiry Committee (QCIC), investigates the roughly 50 cases of suspected audit failure raised in lawsuits each year. It too has no subpoena power and works entirely from public documents and anything the firms may volunteer. Separately, the AICPA runs a system of peer review. Although smaller firms have occasionally been censured by their peers, no Big Five firm has ever failed a review.

Today, even the industry has conceded that this system needs work. According to Ernst & Young chief Turley, the Big Five are working with the SEC to find a way to modify the peer-review process as well as ways to improve the quality of disciplinary proceedings. "The idea that the whole system is broken is wrong," says Charles A. Bowsher, chairman of the POB. "But with the series of alleged failures in the past two or three years, it needs to be looked at and strengthened."

That won't be enough. In light of the questions being raised about the profession's integrity, there is a rising call that oversight be taken out of the hands of the CPAs. The SEC's Pitt is contemplating transferring both auditor regulation and discipline to a new self-regulatory organization (SRO) staffed and overseen largely by outsiders who would take over the review process. The group's board would be dominated by public members. But this too may fall short if it leaves the setting of audit standards in the hands of the AICPA.

Former SEC chief accountant Lynn Turner wants any SRO to also make its findings public. Turner says a properly functioning auditor SRO would work almost like the respected National Transportation Safety Board. "When an airplane crashes in the morning, that night the NTSB is out investigating, and the airline is right there with them. Within a year they come out with a report on what went wrong and mandate certain things get fixed so it doesn't happen again," says Turner. "That's what our SRO needs to do."

But while it sounds good, creating such a body will be far from easy. First of all, to have real power it requires action by Congress, which in a shortened election year already has plenty of other things to do. How it will be funded is sure to be a topic of long and hot debate. Also, the history of SROs has been far from pristine. While the NTSB is highly effective, an auditor SRO is apt to be more like the National Association of Securities Dealers, which has had a spotty record of regulation,

critics say. And any SRO must be set up in such a way, says former senior official at the SEC, "that the whole system hijacked by the firms. The accounting profession is very creative at taking over every group that's ever tried to rein it in."

BAR CONSULTING TO AUDIT CLIENTS

2 What Arthur Levitt couldn't achieve in a year of public hearings, speeches, and backroom bargaining, the Enron scandal may now accomplish. "Ten years from now the auditing profession will look back at that debate on independence and consulting as a missed opportunity," says Jack T. Ciesielski, a CPA and editor of *The Analyst's Accounting Observer*. "Had they willingly gone along with some changes then, maybe they wouldn't be so bad now."

That accountants have become increasingly dependent on consulting is clear. In 1993, 31% of the industry's fees came from consulting. By 1999, that had jumped to 51%. In 2001, for example, PricewaterhouseCoopers earned only 40% of its worldwide fees from auditing, 29% coming from management consulting and most of the rest from tax and corporate finance work, reports the *International Accounting Bulletin*. In a telling, in a study of the first 563 companies to file financial statements after Feb. 5, 2001, the University of Illinois' Bailey found that, on average, for every dollar of audit fees, clients paid their dependent accountants \$2.69 for nonaudit consulting. PricewaterhouseCoopers, based in Bellevue, Wash., had the greatest imbalance, paying PricewaterhouseCoopers only \$534,000 for its audit fees over \$17 million in consulting fees. "That's 30 years of audit fees in one year for nonaudit," points out Bailey. Marriot International Inc. had a similar imbalance. It paid Andersen just over \$1 million for its audit, but more than \$30 million for information technology and other services.

The industry and others argue that conflict of interest is rarely the subject of litigation and that consulting work provides a better understanding of the company and improves the audit. Still, in many people's minds the rising importance of consulting has contributed to a decline in audit skepticism. It simply looks bad to have Andersen earn more on consulting to Enron than on auditing.

ACCOUNTING FAILURES AREN'T NEW—JUST MORE FREQUENT

Investors have lost close to \$200 billion in the past half-dozen years in earnings restatements and stock meltdowns following audit failures. And the pace seems to be accelerating. Between 1997 and 2000, the number of restatements jumped 100%, from 116 instances to 233.

BAUSCH AND LOMB

OCT. 23, 1995

A *BusinessWeek* investigation uncovers multiple accounting abuses by Bausch & Lomb, sparking a Securities & Exchange Commission investigation.



The company later admitted that it had overstated income by \$17.6 million and settled a shareholder lawsuit for \$42 million.



RITE AID

NOV. 11

KPMG resigned as auditor for saying it could not rely on the chain's numbers. Almost a year later, Rite Aid admitted that it had overstated revenue for fiscal 1999 by over \$1 billion.

In August, the company settled a lawsuit with shareholders, but the SEC is still investigating.

y group that has ever tried to rein it in"

DATE ROTATION OF AUDITORS

On September 11, 2001, while the world was glued to the television, Ellen Seidman, director of the Office of Thrift Supervision, testified before the Senate banking committee. Seidman was there to tell the story of the failure of Superior Bank, an Brook Terrace (Ill.)-based savings and loan partly coned by Chicago's Pritzker family, which had collapsed spectacular fashion last July. As part of her presentation, Seidman outlined the role of auditor Ernst & Young in the failure of the bank and its write-off of \$270 million and argued vigorously for auditor rotation. That would "result in a periodic 'fresh look' at the institution from an audit perspective to the benefit of investors and regulators," she said. Ernst & Young blames a large subprime loan portfolio, rising interest rates, and a deteriorating economy for the bank's failure.

Proponents of mandatory rotation of auditors argue that scan-like Waste Management, where income was overstated \$1.4 billion, would never occur if the auditor knew that in a few years it would be out and a competitor would be reviewing its work. Opponents say that rotation could create more problems, since new auditors need time to learn about a company. They prefer the current system of changing audit partners periodically but keeping the same firm in place.

Rotation has the advantage of being relatively inexpensive to implement. "It's a wonderful thing," says John H. Biggs, chief of pension giant TIAA-CREF selects a new auditor every seven years. "If you want a really good peer review, this is the way to do it. You would break through all of these independence issues very clearly and neatly with rotation."

USE MORE FORENSIC AUDITING

4

When the POB began its 2000 review of auditing effectiveness, it brought in a sleuth, Central Michigan University

professor Thomas R. Weirich, to do a study of audit failures. In his review of 40 failures that led to government enforcement actions, he found in a number of cases that the Big Five auditors "did not take that extra step, do that extra work" that would have uncovered the problem. In several cases, for example, at companies that generated their bookkeeping journal entries on computer, unusual manual entries would suddenly appear at yearend, massaging the numbers. The auditors, Weirich says, "didn't ask why."

Some say that any auditor should ask that question, but one way to spur their skepticism might be to introduce some forensic auditing techniques into the average audit. Since revenue-recognition issues and the establishment of reserves are two of the most common reasons for earnings restatements, zeroing in on those hot spots could be the subject of such forensic review. The downside? Some fear that "forensic" audits might end up little more than an excuse for auditors to raise their prices.

LIMIT AUDITORS' MOVES TO COMPANIES

5

The June 19, 2001, SEC enforcement action against Arthur Andersen as auditor of Waste Management from 1993 through 1996 paints a damning picture of cronyism at the waste hauler. Besides the fact that Andersen had audited the firm since before its 1971 initial public offering, from 1971 until 1997 every chief financial officer and chief accounting officer at Waste Management had previously been an auditor at Andersen, according to the SEC.

The SEC charges that Andersen audits had begun to pick up irregularities as early as the late 1980s and that in "its original audits for 1993 through 1996, the engagement team had identified and documented numerous accounting issues underlying misstatements that the restatement ultimately addressed." But those discoveries did not prevent Andersen from giving Waste Management's inaccurate financials their blessing. When Waste Management finally came clean in February, 1998, it wiped out \$1.4 billion in previous earnings.

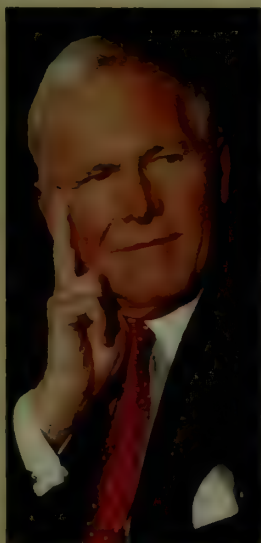
Of course, many companies have similar rotation be-



ANT

1999

agrees to pay \$2.83 billion to shareholders after internal audits revealed CUC's inflated income by \$1 billion through fraud and accounting manipulation. CUC later accepts a \$335 million settlement from CUC auditor Ernst & Young.



SUNBEAM

MAY 15, 2001

The SEC files suit against Albert J. Dunlap and four other former Sunbeam executives, alleging accounting fraud. Earlier, auditor Arthur Andersen settled a shareholder suit for \$110 million, while Dunlap settles for \$15 million in January, 2002.



WASTE MANAGEMENT

JUNE 19, 2001

Arthur Andersen agrees to pay a \$7 million fine after the SEC charges it with issuing false and misleading reports on behalf of Waste Management. The reports overstated income from 1992 to 1996 by more than \$1 billion. Andersen also paid part of a \$229 million settlement with shareholders.

tween their accounting staff and audit firms and never run into problems. And there are legal obstacles to limiting people's freedom to work where they like. But there is still the concern that the numbers might not be scrutinized with the necessary vigor when your old partners

The numbers may not be scrutinized with as much vigor when your old partners are adding them up

to do with reality, but perception becomes reality."

are adding them up. Henry R. Silverman, CEO of Cendant Corp., a franchising company based in New York, was embroiled in the 1998 accounting scandal at CUC International, a direct marketer Silverman's company had merged with that was later found to have inflated pretax income by \$500 million. Silverman has a policy of not hiring people from his auditor, Deloitte & Touche. "It goes to the perception of independence," says Silverman. "It might not have anything

REFORM THE AUDIT COMMITTEES

6 In 1999, an SEC blue-ribbon commission recommended that audit committees be made up solely of independent directors, each of whom should be financially literate, with at least one having accounting or financial management expertise. But when the U.S. stock exchanges moved on the recommendations and adopted new rules for listed companies, they were something else entirely.

Under the New York Stock Exchange rules, directors on the company payroll are permitted, former employees and their families can be allowed after three years, and audit committee members with a "significant business relationship" with the company are also acceptable if the board determines the ties won't interfere with their judgment.

Had the SEC recommendations been adopted verbatim, half of Enron's six-member audit committee likely would have been barred from service. One member has a \$72,000-a-year consulting contract with the company, and two others are employed by universities that have received significant charitable contributions from Enron, its Chairman Kenneth

L. Lay, and their foundations. "The problem for corporate directors is that a lot of companies are doing what Enron," says Russell S. Reynolds Jr., chairman and CEO of the rectorship Search Group Inc. "Nobody but maybe the has the slightest idea what the magnitude of the deal are, and the audit committees certainly don't. It's a hell mess." Chairman Dick Grasso says the NYSE will look to SEC for guidance on any further changes.

CLEAN UP THE ACCOUNTING RULES

7 Accounting has become increasingly complex as business has. "Accounting standards have come so complicated that the challenge is understanding the complicated accounting principles rather than understanding the basic aspects of a company," complains a comptroller of a major industrial conglomerate.

To many, the industry standard setter, the Financial Accounting Standards Board, is too slow to respond to change with new rules. It has been considering rules on special-purpose entities—the partnerships that were at the heart of Enron's troubles—for more than 20 years. As the debate over international accounting standards heats up over the next few years, front-and-center should be a drive toward making them clear, pertinent, and timely. In need of urgent attention are clear-cut rules on materiality and how pro forma numbers are tallied and how that relates back to income. Pitt of the SEC is one who plans to push for an overhaul of FASB. His goal: to get standards made in "months, not decades."

Would all of this have prevented the implosion at Enron? Perhaps not. For all the rules and overseers that have been created in its wake, there is, of course, no substitute for personal integrity. "You're trying to regulate human behavior, and that's going to be difficult at best and often times impossible," says Cendant's Henry Silverman. "It may be impossible to legislate good behavior, a better monitor, the right rules, and some punishment for unethical acts would help. Certainly they would go a long way toward restoring the public's confidence in the bruised auditing profession."

By Nanette Byrnes in New York with Mike McNamara in Washington, Diane Brady and Louis Lavelle in New York, and Christopher Palmeri in Los Angeles, and bureau reports

ENRON

DEC. 2, 2001

Enron files the largest bankruptcy petition in U.S. history amid revelations of off-balance-sheet partnerships headed by company execs and other accounting irregularities. Six weeks earlier, Enron had restated earnings back to 1997, lopping off almost \$600 million in profits.



SUPERIOR BANK

DEC. 10, 2001

The Pritzker family agrees to pay the FDIC \$460 million without admitting liability after the failure of Superior Bank. The prominent Chicago family had been part-owners of Superior. Meanwhile, regulators begin investigating possible miscalculations of the bank's assets.



DOLLAR GENERAL

JAN. 15, 2002

Shares of Dollar General drop 13% after company reduced earnings for the past three years by almost \$200 million. The retailer took a fourth-quarter, 2000, charge of \$162 million to settle shareholder suits over its accounting missteps.

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EDITED BY MONICA ROMAN

MGM: ON THE BLOCK OR ON THE PROWL?

THE HOTTEST DRAMA IN Hollywood is whether the fabled Metro-Goldwyn-Mayer is up for sale or looking for acquisitions. MGM execs have retained investment bankers Goldman Sachs and for months have said they intend to get critical mass through acquisitions or a merger. The studio, majority-controlled by billionaire Kirk Kerkorian, refused to confirm published reports that it has put itself on the auction block for an estimated \$7 billion. In recent months, MGM has held talks with Sony, DreamWorks SKG, and others about its library of more than 4,100 movies, including the James Bond and Pink Panther series. It has also bought or launched more than a dozen cable channels worldwide on which to run its films. Last year, MGM also paid \$825 million for 20% of Rainbow Media, which owns U.S. cable channels including

Bravo and American Movie Classics.

AN INTEL INSIDER MOVES UP

INTEL VETERAN PAUL OTELLINI became heir apparent at the giant Santa Clara (Calif.) chipmaker by being named president and chief operating officer. Otellini, head of Intel's core microprocessor business since 1998, fills a COO post that has been vacant for nearly four years. With Intel struggling to find its way out of the worst semiconductor sales slump in history, Otellini, 51, will oversee the day-to-day development and delivery of new products and technologies. CEO Craig Barrett, 62, who gives up his title as president, will focus on corporate strategy and long-term planning.

TAKING AIM AT TYCO—AGAIN

TWO YEARS AFTER ITS STOCK was shellacked by short-sellers, Tyco International is once again under fire. On Jan. 15, its stock plunged 8.5% after Tyco warned that because of weakness in its electronics business, earnings would rise only 14% to 17% in the quarter ending Mar. 31, instead of the 23% expected by analysts. And the stock has fallen some 20% since Jan. 1, amid rumors of possible SEC investigation of its accounting. Sources close to the matter deny that the SEC is investigating, and Tyco dismissed the rumors.

A WTO BLOW FOR UNCLE SAM

THE COSTLIEST TRADE DISPUTE ever between the U.S. and the European Union is nearing an end. On Jan. 14, a World Trade Organization appeals panel ruled that the

HEADLINER: ROBERT WILLUMSTAD

THE CITI AFTER SANDY?

CITIGROUP TAPPED ITS CONSUMER-lending chief, Robert Willumstad, as president on Jan. 15. Willumstad, 56, fills a spot vacant since James Dimon, now Bank One chairman, was ousted in 1998. The move helps silence criticism that CEO Sanford Weill, 68, has no succession plan, but it doesn't guarantee Willumstad the top job. The reserved exec has run Citigroup's global consumer division since December, 2000. The unit, whose income grew more than 20% in the first nine months of 2001, contributed to Citigroup's relatively stable

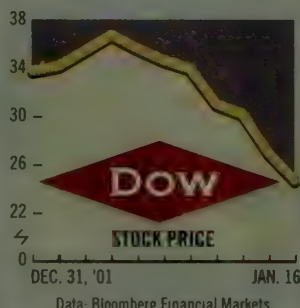


earnings. Willumstad now takes on added financial and human-resources duties. A onetime Chemical Bank executive, Willumstad has worked with Weill for 15 years, first at Commercial Credit, which became Travelers Group. He's the last remaining high-profile Weill loyalist at the company. Last year, vets Joseph Plumeri and Jay Fishman left to head insurance firms. But Weill isn't heading out soon. "You'll learn about my succession plans when the company decides to name a successor," says Weill. *Heather Timmons*

CLOSING BELL

FALLING DOW

When it took over Union Carbide last year, Dow Chemical hoped to gain market share and economies of scale. Turns out it also acquired a docket of asbestos liability. After settling a Texas lawsuit against Carbide on Jan. 9, Dow shares fell 29%, closing at \$24.55 on Jan. 16. Dow calls its liability immaterial.



U.S. tax code contains a \$4 billion-a-year export subsidy that violates international trade law. The U.S. now has tough choices: higher European tariffs on U.S. exports or lower U.S. tariffs on European imports. Other options include ending the U.S. export subsidy, resulting in a tax increase on U.S. multinationals, or doing away with all foreign-source income taxes, which means a big loss for the U.S. treasury. The WTO is expected to decide by Mar. 28 the amount of penalty tariffs that Europe can levy on U.S. exports.

DEFLATING THOSE PRO FORMA FIGURES

COMPANIES THAT WANT TO PUFF up earnings, take heed. On Jan. 16, the Securities & Exchange Commission for the first time went after "pro forma" numbers—earnings and revenue figures that don't fol-

low generally accepted accounting principles. The charged Trump Hotel & Casino Resorts with fraud in connection with its 1999 third-quarter, when it reported erating earnings of 63¢ share. The company's press release noted that the pro forma number excluded one-time charge of \$81.4 million but didn't disclose that it included a one-time gain of \$17.2 million. Trump Hotel & Casino agreed to cease and desist from improperly reporting earnings without admitting or denying the charges and wasn't fined.

ET CETERA...

- AT&T will pay \$2.6 billion to consulting firm Accenture to help it cut costs.
- Jeff Mallett resigned president and COO of Yahoo.
- Nucor dropped its opposition to U.S. Steel's plan to take over seven steelmakers.

EDITED BY RICHARD S. DUNHAM

WHY HIGH TECH HAS FALLEN OFF WASHINGTON'S A-LIST

During the high-tech boom years, when Washington discovered campaign gold in Silicon Valley, lawmakers competed to play Santa to computer and software companies. That was then. Except for a two-year extension of the moratorium on new Internet sales taxes, the bills that Silicon Valley got behind and that got passed in 2001 were mostly mainstream initiatives, like mandatory tests for elementary school kids.

Things aren't likely to improve anytime soon. The tech-related issues that Washington will debate in 2002—from stoking demand for high-speed data networks

to protecting online privacy—are complex and divisive. And amid election-year politics, techies will have a tough time with their nonpartisan agenda. "We're going to get a lot of 'at bats' this year," says William T. Archey, president of the American Electronics Assn.

Not a very upbeat assessment, but a realistic one. The tech-led downturn has dimmed the industry's rock-star status, and fiscal reality has forced some tech titans to scale back their Washington presence. Faced with a recession, once-fawning lawmakers are more interested in economic stimulus than just lending Silicon Valley a hand. "Leadership is favoring bills that have broad business appeal," says Representative Bob Goodlatte (Va.), a tech champion.

What's more, the September 11 attacks elevated security and economic concerns, scuttling an industry-backed move to liberalize export controls on computers and software. The FBI and Pentagon say the curbs are needed to keep sophisticated equipment out of the hands of terrorists. House leaders edge to revisit the issue soon, but opposition remains stiff. Besides that, the ascendancy of George W. Bush has been a mixed blessing. A proposal to allow faster write-offs of

computers and other capital-equipment purchases—and thus stoke demand—is part of the bogged-down stimulus package. But the Clintonites' unabashed adulation of the geek set has given way to a muted admiration from the new team. "The Clinton-Gore Administration cared about technology out of proportion to its political importance, and this Administration doesn't," says tech lawyer Stewart A. Baker.

Broadband, the techies' high-profile issue for 2002, is tricky, too, though not for partisan reasons. "Just as putting a person on the moon was a national goal, getting broadband to all

Americans and small businesses should have the same effort behind it," argues Cisco CEO John T. Chambers. He and fellow execs are seeking incentives to rev up demand for high-speed Net service, currently used by only 11% of U.S. households. Wider use of broadband could create a market for movies-on-demand and other high-bandwidth applications. That, in turn, execs say, will trigger new sales of PCs and other gear. Trouble is, there's no consensus yet on a policy prescription.

On other fronts, tech is playing defense. Companies fear privacy legislation will limit their ability to market to Net

customers. And hardware makers are aghast at Senate Commerce Committee Chairman Ernest F. Hollings' (D-S.C.) push to mandate technology to thwart copying of movies and music. "We don't want the government saying we have to have certain kinds of technology in computers," says Ralph Hellmann of the Information Technology Industry Council.

With \$5 million donated by software and Net companies and their execs in the first nine months of 2001, high tech is still ponying up the cash that buys access. But as techies are discovering, money alone won't buy happiness in Washington.

By Amy Borrus



Bill Gates schmoozing on the Hill in '99

CAPITAL WRAPUP

STIMULUS HITS A SNAG

President Bush's economic stimulus plan may be about to lose a key Senate backer. The top Republican on the Finance Committee, Iowa's Charles E. Grassley, says if Congress can't pass a package by Feb. 1, it ought to just forget it. "As time goes on, there is less need for it and more danger in passing it," Grassley says. Even without the plan, he predicts, an extension of unemployment benefits and restoration of special interest tax breaks that expired on Dec. 31 will be approved.

A PERFECT 10

► While Ken Lay may disagree, it often pays to have friends in high places. Just ask actress Bo Derek. The onetime starlet, now a pet-care-product entrepreneur, has been picked for a coveted six-year term on the Kennedy Center's governing board. Derek, a rare Republican in Hollywood, has developed a close friendship with Deputy White House Chief of Staff Josh Bolten. Derek accompanied Bolten to the Kennedy Center Honors gala on Dec. 2.

MORE BUCKS FOR THE FDA

► The drug industry has been fretting that without a Food & Drug Administration commissioner in place to plead its case, the FDA will lose out in Bush's upcoming 2003 budget. But sources say the agency is actually slated for the "biggest increase in years." FDA officials credit Health & Human Services Secretary Tommy G. Thompson with realizing that the agency's budget hasn't kept up with its new responsibilities, such as protecting the food supply from terrorists.

CHINA

BANKS UNDER A CLOUD

Scandal at Bank of China highlights questions about China's Big Four

For more than a decade, Wang Xuebing shone as one of the brightest stars in Chinese finance. In 1993, he took over as head of the Bank of China, the country's second-largest, and two years ago began running another of the Big Four banks, China Construction Bank (CCB). He was part of an elite cadre of officials singled out by Premier Zhu Rongji to restructure China's tottering state-owned banks. Indeed, as an official with Cabinet-level rank Wang stood close to the center of power.

Now Wang has been fired from his post and detained on suspicion of corruption—a charge that could result in the death penalty. On Jan. 11, after repeated denials from China Construction Bank officials that anything was amiss, Beijing confirmed rumors that Wang

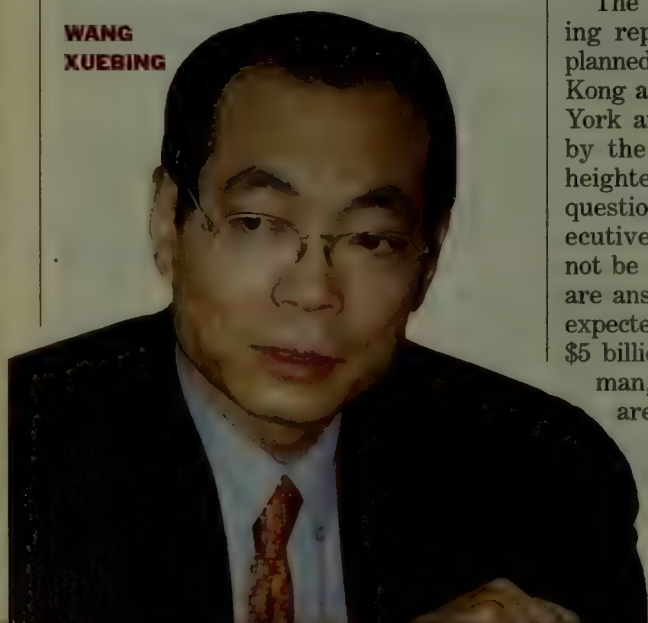
had been removed as head of the bank.

People in China and Hong Kong familiar with the situation say that Wang is being investigated in connection with a \$23 million loan linked to his wife. The loan, say sources, was arranged through Bank of China's Hong Kong office in 1994, when Wang was in charge. The loan was secured by vastly insufficient collateral, and was not repaid—until the bank itself covertly covered the cost through its New York office. Because of the American connection, the affair is also being investigated by U.S. authorities. *BusinessWeek* has learned that Bank of China may soon agree to pay a fine of more than \$10 million to the U.S. and to the People's Bank of China (PBOC), the central bank.

Wang did not respond to requests for an interview and did not answer a detailed list of questions sent to him. But at a Jan. 15 press conference, PBOC Governor Dai Xianglong confirmed that Wang had been removed from his job and that a probe was under way: "Wang Xuebing had direct responsibility for loan cases that happened in some Bank of China branches...the relevant departments will continue investigating the problem of comrade Wang Xuebing."

The case promises to have far-reaching repercussions. Bank of China had planned to list its highly profitable Hong Kong and Macao operations on the New York and Hong Kong stock exchanges by the middle of the year. "This will heighten investor skepticism and raise questions," says a financial-industry executive in Hong Kong. "The IPO will not be successful unless these questions are answered." The landmark deal was expected to raise between \$2 billion and \$5 billion. The blue-chip firms of Goldman, Sachs & Co. and UBS Warburg are two of the underwriters.

WANG
XUEBING



The Wang case is the latest in a series of scandals that underscore the banking sector's weak system of controls. The PBOC said early this month that it was censuring all of the Big Four banks, which control two-thirds of the country's banking assets, and was dismissing 686 members of their staffs. Wang's reputed offense pales in monetary terms beside another recent scandal. Chinese and Canadian authorities are hunting for a number of ex-Bank of China managers who they believe stole a staggering \$480 million from the Guangdong branch between 1992 and last year. Hong Kong police say three

Wang was seen as one of China's



THE BANK OF CHINA, BY THE NUMBERS

FOUNDED In 1912, the year China became a republic

OWNED by China's government, but plans to split off the Hong Kong and Macao operations in a \$2 billion-to-\$5 billion share offering this year

TOTAL ASSETS \$382 billion at the end of 2000, ranking it among the world's 30 largest banks

PROFITS \$1.3 billion, pretax, in 2001

NONPERFORMING LOANS Equaled 29% of total loans at the end of 2000. Under 6% is the international norm

BRANCHES 12,967 in mainland China, 443 in Hong Kong and Macao, and 117 outside of China

HONG KONG OFFICE: Will investors steer clear of the IPO?

Wang had a reputation as a financial reformer who put a sharp focus on profitability. In an interview with *BusinessWeek* last February, Wang preached the need for banks to emphasize earnings over size. "When I asked questions about performance, [employees'] answers usually centered around loan growth," he complained. "My question is: How much profit are you generating for me?... I don't think our employees understand the real importance of profitability."

Former employees say he was serious about instituting reforms. "He was very up-front in terms of reform measures," says a former Construction Bank executive, pointing to stepped-up efforts to upgrade CCB's creaky computer network and, oddly enough, build stronger internal controls. Wang was also chairman of China International Capital Corp., the country's only international investment bank, which is 34%-owned by Morgan Stanley.

Wang's troubles apparently began back in 1995 with the publication of an article in the muckraking Hong Kong weekly, *Next Magazine*, about the \$23 million loan. To this day, it is not clear exactly under what circumstances the money was borrowed or how it was spent. In the end, however, the loan, which originated in Los Angeles, was paid back not by the borrowers but by a new loan issued by Bank of China itself, through its New York branch.

A series of real estate documents examined by *BusinessWeek* show that a Taiwanese singer, Steven Liu, and his actress wife, Nicole Chang, assembled

16 parcels of land in Riverside County, California, between 1986 and 1990, paying \$1.65 million. The Bank of China's Los Angeles branch apparently valued them at much more, since on Oct. 20, 1994, it extended the \$23 million loan to Liu and Chang, secured by the properties. Less than two months later, on Dec. 15, a corporation that sources say was one-quarter owned by Wang's wife, Zong Lulu, bought the properties for \$1.5 million. Chinese investigators suspect that Wang was involved in arranging the loan and that some of the proceeds ended up in his wife's hands. In 1995, Bank of China's New York office repaid the loan after *Next* raised questions about it, according to someone familiar with the probe. Neither Liu, Chang, nor Zong Lulu could be reached for comment.

Initially, Wang deflected the charges by claiming that they were fabricated by anti-China forces. But after the New York branch paid off the loan, disgruntled employees there brought this to the attention of U.S. regulators. After an investigation by the Office of the Comptroller of the Currency (OCC), which oversees banks, U.S. authorities threatened to close the bank's New York branch. Since then, U.S. and Chinese regulators have been quietly hashing out a settlement. *BusinessWeek's* sources say Bank of China will have to pay more than \$10 million to the OCC and the People's Bank of China. Officials at the OCC and the PBOC declined to comment.

Beijing's willingness, however belated, to go after one of its most senior officials shows a continued desire to clean up its banking establishment. But other Chinese banks will continue to rely more on moral suasion to police themselves than on a Western-style system of audits and government surveillance. That means rigorous and honest corporate governance will be a sometime thing. "China's economy is rapidly outgrowing its regulatory institutions," says Joydeep Mukherji, an analyst at Standard & Poor's in New York. "Continued reform depends increasingly on bringing practices more into line with international norms." But it could be years before effective new safeguards are in place. Prospective investors in China's banks should heed the warning.

By Mark L. Clifford in Hong Kong, with Alysha Webb in Shanghai, Dexter Roberts in Beijing, and Petti Fong in Vancouver

se suspects have fled to Canada. The charges against Wang are especially bad news for the stock listing because they involve the Hong Kong branch. At least one key meeting concerning the suspect \$23 million loan took place at the bank's glittering 70-story Hong Kong headquarters. The Hong Kong branch's First Deputy General Manager, Liang Xiaoting, was arrested last year and is now being detained in Beijing along with Wang, according to several sources. Efforts to reach Liang have been unsuccessful.

The idea of Wang's getting involved in such proceedings is shocking to many.

Financial reformers. Now, he could get the death penalty

ITALY

MAKING OVER YSL IS NO STROLL DOWN THE CATWALK

But Gucci is making steady progress in sprucing up the brand

When movie star Nicole Kidman turned up for the opening night of the Cannes Film Festival last May clad in a black silk strapless dress with ruffles—the work of designer Tom Ford for Yves Saint Laurent—she sparked a global run on the \$6,500 frock. That was good news for Gucci Group Chief Executive Domenico De Sole, who paid \$1 billion in December, 1999, for the tarnished YSL ready-to-wear and perfume businesses. Two years of the Gucci treatment—a special blend of De Sole's hard-nosed management and Ford's impeccable design instincts—have restored much of the brand's lost luster. “The fall and spring collections have had nothing short of a spectacular response from clients,” says Ronald L. Frasc, chairman and CEO of exclusive New York retailer Bergdorf Goodman.

The YSL makeover is a vital step in transforming Gucci from a single-brand luxury house into a multibrand powerhouse. It hasn't been a stroll down the catwalk, though. To cement his control over YSL, De Sole had to slash away at a thicket of licensing agreements that provided up to 75% of the fashion house's revenues yet devalued its image by imprinting the YSL logo on everything from cheap sunglasses to baseball caps. “It was really painful,” recalls the CEO. “We started from zero.” Meanwhile Ford, already under pressure to create a winning new image for YSL, had to contend with ill-concealed disapproval from the brand's founder, fashion legend Yves Saint Laurent. Now, the 65-year old designer's decision to retire and close his money-losing

haute-couture atelier will make it easier for De Sole and Ford to put their own stamp on YSL's mainstream operations.

Analysts expect 2001 revenues at the relaunched fashion business to total \$90 million for the fiscal year ending Jan. 31, down slightly from 2000 but ahead of target given the plunge in licensing income. Still, heavy investments in new boutiques and five budget-busting Paris



NEW LOOK FOR A FASHION HOUSE

BRAND CONTROL Gucci terminated 152 licenses for YSL products, halting a slide in quality and reputation.

NEW DESIGNS Ready-to-wear collection was relaunched under the aegis of Gucci creative director Tom Ford.

STORES Opened 27 new stores, hiking own-store sales by over 100% since August. Plans to add an additional eight in 2002.

ACCESSORIES Introduced new line of leather goods. Restructured \$475 million perfume and cosmetics division.

Data: BusinessWeek

KIDMAN IN YSL: THE GOWN WAS A HIT

fashion shows have led to an estimated \$75 million loss in 2001. Full-year profits are not expected to materialize until 2004—a year later than first forecast, prompting grumblings from some analysts that Gucci paid too much for YSL. “They underestimated where the brand had fallen to,” says Dana E. Cohen of Banc of America Securities in New York. But the perfumes and cosmetics unit, YSL Beauté, is already in the black: For 2001, it is expected to register an operating profit of \$43 million on sales of \$475 million.

De Sole and Ford, who boosted Gucci revenue tenfold, to \$2.4 billion from 1994,

hope to spur dramatic growth at Ford must keep producing fashion for YSL, which he has positioned more glamorous alternative to Gucci's hard-edged sexiness. Example: a cotton bare-shoulder peasant blouse priced at \$1,143. It hit stores in and sold out in weeks, inspiring a whole new line of knock-offs by mass-market manufacturers such as Spain's Zara.

De Sole's next test is to generate sales in high-margin accessories such as handbags, eyewear, watches, perfume and cosmetics. “They have to find a way to apply the same trickle-down strategy at YSL [as at Gucci],” says Armando Branchini, president of Milan fashion consultancy InterCorporate. Leather goods account for less than 10% of sales at YSL, compared with 45% at the Gucci division. Already YSL's Mombasa African-inspired handbag with a

handle and a price tag, spring fashion “We sold 80% of our order in the first week,” Bergdorf's Frasc.

No question management faces a challenge—and risks—for De Sole and Ford are bigger than they had run in single-brand company. The two invest heavily to grow seven small companies purchased over the past months, including the fashion house Alexander McQueen and Stella McCartney and leather goods maker Bottega Veneta. De

a 58-year-old former tax lawyer joined Gucci's U.S. operations in 1999, says the shopping spree may not be “In difficult times, you get interesting breaks,” says De Sole, who points out that while some of his heavily indebted competitors are suffering, Gucci is sitting on a \$1.5 billion war chest.

Meanwhile, De Sole is already winning cost savings from combined room operations. YSL's Mombasa for example, was produced by Gucci's Tuscan network of skilled leather craftsmen. Smart designs, great execution. The YSL brand is starting to recapture its star allure.

By Gail Edmondson in Florence



WHAT KIND OF DECISIONS ARE REQUIRED IN TODAY'S BUSINESS CLIMATE? SMART ONES.

Living at a smart business
decision can happen anywhere.
The process first requires
information; information that
needs to be gathered from multi-
sources, then analyzed and
acted before it can be used to
your advantage.

The challenge today is twofold.
One: how do you get the
infrastructure in place to access
disparate data sources and
create and distribute actionable
information? And, two: also
meet the demands to reduce
costs and increase productivity?

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analysis and web-based informa-
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LOTS OF GREEN: Heineken far has treated investors

THE NETHERLANDS

FREDDY HEINEKEN'S RECIPE MAY BE SCRAPPED

To thrive, the brewer could be forced to try big acquisitions

He was the marketing whiz who dressed Heineken beer in green. He was the visionary who understood that a good brew could travel and proved it by turning a venerable Dutch lager into the best-known beer brand in the world—the sudsy equivalent of Marlboro or Coca-Cola. Through it all, Alfred “Freddy” Heineken turned his controlling one-quarter stake in the family business into a \$4 billion fortune, Holland’s biggest. And when he died in early January at 78, he left behind one of Europe’s storied family-controlled empires.

But family companies, even rich ones like \$8.7 billion Heineken, tread uphill in the global economy. For years, Heineken has had to limit acquisitions and rule out mergers in order to leave Freddy Heineken in control. Now, as his fortune passes to his daughter, Charlene de Carvalho, a housewife and mother of five in London, the rules could change. “This could be Heineken unchained,” says Michael Kraland, the Dutch president of Trinity Capital Partners, a Paris investment firm.

Heineken officials insist that nothing will change in the way the brewer does its business. They say the April retirement of Chief Executive Karel Vuursteen and his replacement by longtime No. 2 Thony Ruys, 54, spells continuity.



DE CARVALHO:
Inherits her father's stake

And Heineken’s son-in-law, Michel de Carvalho, a vice-chairman of Schroder Salomon Smith Barney in London and Heineken board member, speaks for his wife, saying: “We won’t deviate from the old man’s principle.”

Trouble is, the old man’s principle looks increasingly out of date. In Heineken’s key European and American markets, demand is flat. This is pushing growth-hungry brewers to buy their rivals. Heineken has been snapping up bite-size na-

tional brewers from Italy’s Moretti to Spain’s Cruzcampo. But in big deals it’s getting outflanked by its chief rival in Europe, Belgium’s Interbrew. In two years, Interbrew has dished out \$5.5 billion for brands such as Germany’s Beck’s and Britain’s Whitbread and Bass. Now Interbrew is vying with Hei-

neken for the global No. 1 position behind U.S.-based Anheuser-Busch Cos.

So its decision time for the family. To stay in the game, Heineken will need money—lots of it. Vuursteen, the blue-chip company cannot grow what it needs, even millions of dollars for takeovers. But as Heineken takes on rivals in crucial markets from China to America, it will need all the flexibility it can get. If Hei-

neken execs don’t have the power to sell shares to raise cash for an acquisition, to use shares as takeover currency, the venerable Dutch brewer could lose in bidding wars and see growth stall. But if the company takes either of these routes, the family’s grip—it controls over half of the holding company—in turn holds a hair more than Heineken stock—would no longer be decisive. Vuursteen, who works in the Heineken family’s old portrait-lined room, now part of the Amsterdam headquarters, acknowledges that “in the term, nobody knows what will happen.”

Heineken’s conservative approach to served shareholders’ interests just now. With its dominance of Europe and a luxury niche of 2.2% of American vast market, Heineken has raked in double-digit earnings and sales growth much of Vuursteen’s nine-year tenure. Schroder Salomon Smith Barney predicts a 15% earnings rise for 2002, \$711 million. And the stock, while up 20% in the past 14 months, is not double the level of four years ago.

For now, the family control protects Heineken from a takeover. Without a defense, analysts say, Heineken could find itself consumed by Anheuser-Busch or even Coca-Cola. More likely, Heineken will look to bulk up, financing

acquisitions—at least for the next year or two—with bank loans. Targets? They could range from Philip Morris Cos. to Miller Brewing Co. to the family-controlled empires of South America. If Heineken finds itself goaded outbid again by feisty Interbrew, Freddy Heineken’s family business could be in for a change.

By Stephen Baker
Amsterdam, with Chris White in Paris and Omer Kharmouch in New York



GROWTH SLOWS AT HEINEKEN



Source: Heineken, Schroder Salomon Smith Barney



WHAT KIND OF DECISIONS DOES SAP MAKE? SMART ONES.

...ing at a smart business
...ision can happen anywhere.
...t the process first requires
...formation; information that
...eds to be gathered from
...ultiple sources, then analyzed
...d shared before it can be

used to your advantage.
SAP, the world leader in e-busi-
ness platforms, is focussed on
finding new ways to help their
customers lower costs and
increase revenues.

That's why SAP chose
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technology and expertise to
help their customers better
utilize information through
formatted reporting for
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www.crystaldecisions.com/ent/005/

EDITED BY ROSE BRADY

PAKISTAN: SO FAR, MUSHARRAF IS PLAYING A CLEVER HAND

As Pakistan's General Pervez Musharraf wrapped up his televised speech on Jan. 12, bursts of automatic fire could be heard in the streets of Karachi—believed to be shots of protest from supporters of the religious schools Pakistan's President was vowing to rein in.

The reaction was a sharp reminder that Musharraf is walking a dangerous tightrope as he tries to avoid all-out war with India one month after its government accused Pakistani-linked terrorists of attacking the Parliament in New Delhi. Musharraf's declaration that Pakistani groups involved in terrorism and religious extremism would not be tolerated—coupled with hundreds of arrests days later—have somewhat placated Indian officials, who say they may soon start pulling back some of the 550,000 Indian troops on Pakistan's border if Musharraf puts his words into action. The radical elements of Pakistani society, however, remain deeply suspicious of Musharraf's attempts to curb terrorism and turn Pakistan into what he calls a "progressive Islamic welfare state."

Yet in any struggle for power in Pakistan, two forces count for far more than the anger of the street—the army and Inter-Services Intelligence, the military intelligence agency. Both the army and the ISI have long backed separatist violence in Kashmir, the territory whose control Pakistan disputes with India. No surprise, then, that many analysts have figured Musharraf's control of the army and the ISI might weaken as he took on extremists and the crisis with India progressed. Talk of a coup against Musharraf has been frequent.

Musharraf, however, has played his hand cleverly. Although he is standing up to extremists, he is keeping support for Kashmiri Muslims as key policy goals for Pakistan. "He hasn't compromised on Kashmir," says retired General Hameed Gul, a former ISI chief. That means "Musharraf

does enjoy the support of the army and the ISI," he says.

Musharraf likely consulted key generals on his speech. he has also been tough with the top brass. The President has been careful to remove powerful figures who could provide a focal point for resistance. Since Pakistan withdrew its support for the Taliban in Afghanistan, he has tightened his grip on the agency's chief. Haq replaced Lieutenant General Mahmud Ahmed, believed to be pro-Taliban. Musharraf has also reformed the military command structure, replacing key generals with his own men. He's made it clear that the army won't be neglected as \$600 million in aid from Washington pours in. Pakistan gets \$12 billion in foreign debt rescheduled. Musharraf has pledged to combat poverty, but the aid also frees other funds for the military, which takes 70% of the state budget each year.

Now Musharraf is hoping that the pressure from New Delhi and Washington will let up. "The crucial concern that the U.S. has [is] that Pakistan not be pushed down the slippery slope of one concession after another to the Indians," says Stephen P. Cohen, an expert on South Asia at the Brookings Institution. Musharraf will score big points if India pulls its troops back. He might renew his request for U.S. military aid as a logical quid pro quo for helping the U.S. go after the al Qaeda terrorist network.

Beyond the immediate crisis, Musharraf must decide whether to hold elections planned for Parliament and Provincial Assemblies in October. Of course, if he averts war and keeps the army in check, he will be stronger than ever. That will make it easier for him to fulfill his own goal of remaining in power as President, even as Pakistan inches back toward democracy.

By Nawaen Mangi in Karachi, with Manjeet Kripalani in Bombay



MUSHARRAF: Will India pull back?

GLOBAL WRAPUP

FRENCH MAGISTRATES PROTEST

► The resignation on Jan. 13 of French magistrate Eric Halphen, who had headed an anticorruption probe of President Jacques Chirac, has sparked concerns that France's judicial system is bowing to political pressure. An appeals court, accusing Halphen of procedural errors, removed him last fall from the Chirac case, which focuses on alleged corruption during the President's tenure as mayor of Paris in the 1980s and early 1990s. Halphen now says he was wiretapped, followed, and secretly

filmed while working on the case.

In the wake of his resignation, national magistrates' organizations have denounced the appeals-court ruling and warned that efforts to root out corruption are being compromised. Although the Chirac investigation continues under another magistrate's direction, the President enjoys immunity while in office and is seeking reelection this year to a five-year term.

JAPANESE DONOR FATIGUE?

► As Tokyo prepares to host an international conference on Jan. 21 to

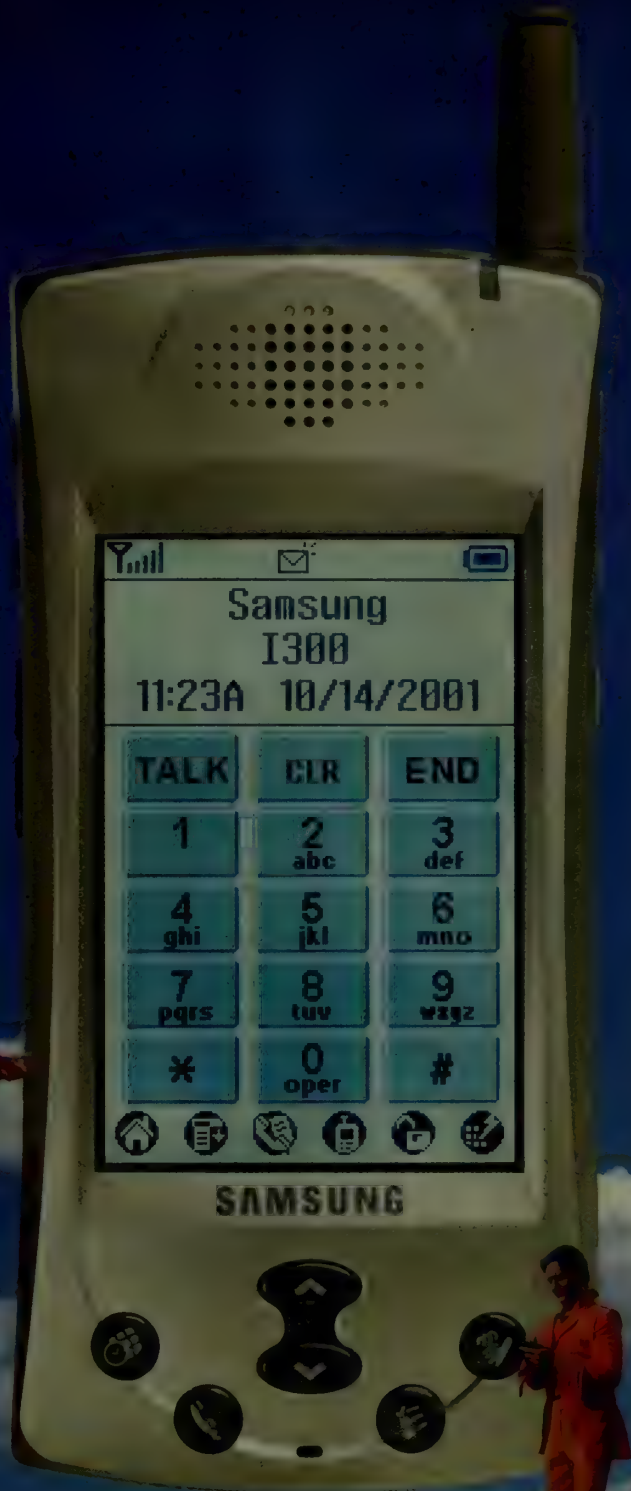
drum up reconstruction money for Afghanistan, the U.N. and two other agencies have released their estimated cost of the project—\$15 billion over 10 years. Key donors are likely to be the U.S., the European Union, Saudi Arabia, and Japan, which may foot some 20% of the bill. Checkbook diplomacy is losing popularity in cash-strapped Japan, however. After 10 years as the world's single most generous donor nation, Japan has slashed its overseas aid budget by 10%, to \$1.5 billion, for the fiscal year starting Apr. 1, 2002.

SAMSUNG

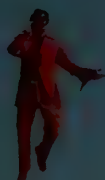
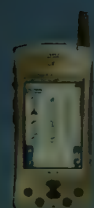
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Many mutual-fund investors don't know which way to turn. Little wonder: After every quarter of gains in the past two years, the market has come right back with three months of devastating losses. And the obvious strategies of exploiting gaping disparities of value—between large-cap and small-cap stocks, for example, or between growth and value stocks—have run their course as the differences have narrowed. Even the superior returns of bonds over stocks in the past couple of years are unlikely to be repeated soon.

So what should investors do now? The worst tactic is to sit on the sidelines, even if “you’re so terrified that you have to pick your stomach off the floor,” says Mary Lisanti, chief investment officer for domestic equities at ING Pilgrim Investments Inc. “That’s what buying low is all about.”

And that’s where our Mutual Fund Scoreboard comes in. If you’re searching for funds with solid track records and seasoned managers, the 17th edition of the Scoreboard is a good starting point. It is prepared for *BusinessWeek* by Standard & Poor’s (both are owned by The McGraw-Hill Companies). We’ve sifted through a database of 3,493 equity funds and found an elite group that produces the best returns for the least risk. Only 150 in total—fewer than 1 in 20 funds—make the cut and earn our overall A rating (table, page 62). Others get the top grade for being among the best funds in their category (table, page 64).

The A-rated funds are the pick of the long-term buys. They’re not surefire winners year in and year out, but they have the best risk-adjusted returns over five years. How do we know? We’ve adjusted each fund’s pretax returns for the amount of risk the manager ran to achieve the results. Month by month, over five years, we check whether the fund managed to beat the risk-free return on Treasury bills. Each time it fails, it earns negative marks. The bigger the sum of the negative numbers, the higher the fund’s risk of losses.

Results for the 605 largest funds start on page 70. Ranging from the \$79 billion Fidelity Magellan Fund to the \$596 million Templeton Global Smaller Companies Fund, they represent almost 90% of the assets of all the funds in our database, shown in its entirety online at www.businessweek.com/mutualfunds. The online returns—and ratings—are interactive and updated monthly.

The A-list runs the gamut from the racy to the reserved, reflected in five levels of risk ratings, from very high to very low. If you’re game for a wild ride, you might choose one of only two tech funds that won top scores this year. The Kinetics Internet Fund earned a 36% annualized return over five years, the highest of all the A-rated funds. Although the

payoff has been spectacular, investors have been whipped. The fund earned 219% in 1999 but lost 51.5% the following year, making it the only A fund to get a “very high” rating. Since then, the managers have toned down their picks by buying household names, such as Washington Co. and Liberty Media, AT&T’s spin-off. Last year, they lost 9.6%—about a third as much as its peers.

Most of our A-list funds are at the other extreme, with low or very-low risk levels. Three funds run by Wells Fargo Asset Management, a unit of Wells Fargo Bank, are practicing autopilot, racking up annual returns of between 8.6% and 11.7% over five years: Growth Balanced, Moderate Balanced and Strategic Income. These funds invest in other Wells Fargo funds run by a variety of managers. They start with preset

portfolios of stocks and bonds and use computer models to adjust the mix. The aim is to create a smooth ride. By contrast, if you go with the star-managers, you may have more volatility,” says Wells’ Director of Asset Allocation, Gale Blomster, who designed the models in 1989. “But you have more volatility.”

Many managers of top funds have earned their stripes by taking the road less traveled. Consider Franklin Resources’ Mutual Fund, which had a hard time attracting and keeping investors in the late 1990s. With the return to favor of value investing, the funds’ long track record has seen them through, and a handful of A ratings. “Now investors realize they were throwing away real businesses for get-rich schemes,” says Chief Investment Officer David Wier. He and his team select funds using the same criteria they have for the 15 years they have been with Mutual Shares. Often, they get their best investment ideas from the market’s daily new-low list. The team is especially keen on undervalued or deeply discounted stocks, such as bankrupt California utility Pacific Gas

and Electric and companies grappling with restructuring pain, including E.W. Scripps, Federated Department Stores and White Mountains Insurance.

Many of the best-performing funds are all-weather funds that excel no matter what the market climate. Their managers are rarely content to follow the pack, which is currently buying up cyclical consumer and industrial stocks, anticipating a boom once the U.S. economy kicks into gear. Scott Schermerhorn, the manager of two A-rated funds—Liberty Growth Income and Liberty Utility—says he doesn’t base his hope and a prayer for future returns. “I’m buying stocks that are paying us today, vs. trying to speculate on what company is going to make three or four years from now,” says Schermerhorn, who manages \$3.5 billion in large-cap stocks for Fleet Asset Management. He likes such stocks as Allegheny Energy, a diversified utility company that

Special Report

THE BEST MUTUAL FUNDS

In a tough year,
surefooted managers
keep going strong



a 4% yield while expanding earnings a modest 6%. Unlike other utility managers, who loaded up on emerging telecom-related issues, Schermerhorn stayed away—and he's still bearish on the sector.

The Scoreboard's details of cash holdings highlight which managers have full faith in the U.S. stock market. Lately, some have more stashed away in greenbacks than in stocks. "It's better to spend time avoiding problems than trying to find that big winning stock," argues Manu P. Daftary, manager of the \$360 million Quaker Aggressive Growth Fund. In

1999, when the bull was raging, he had 60% of the fund's assets in cash. Yet the

"One cause of failure is being afraid to fail; you have to take judicious chances"

RAJEEV BHAMAN

Oppenheimer Funds



"We're not seeking the fastest-growing. We're looking for steady growth"

SANDI GLEASON

Kayne Anderson Rudnick

Special Report

THE BEST MUTUAL FUNDS

fund surged 99% that year because two-thirds of its investments were in tech stocks, such as Check Point Software Technologies Ltd. and Powerwave Technologies Inc. Last year, Daftary was as much as 90% in cash but halved that in the fourth quarter when he bought beaten-down tech and drug stocks, such as Abbott Laboratories, Rational Software, and Network Associates, betting "a little bit early" on an eventual tech-sector rebound.

It helps to know which funds make big concentrated bets, too. You can find that information in the Scoreboard, which gives the percentage of assets accounted for by a fund's top 10 stocks. Mutual-fund managers who buy a limited number

Best in Show

These equity funds each earned an A for delivering the best risk-adjusted total returns over the past five years

FUND	AVERAGE ANNUAL TOTAL RETURN (%)*	CATEGORY	RISK	FUND	AVERAGE ANNUAL TOTAL RETURN (%)*	CATEGORY	RISK
AIM BASIC VALUE A	16.7	Large-cap Value	Low	FIDELITY SELECT BIOTECHNOLOGY	21.5	Health	High
AIM GLOBAL HEALTH CARE A	16.5	Health	Low	FIDELITY SELECT BROKERAGE & INVEST.**	21.1	Financial	High
AMCAP A	16.1	All Cap	Low	FIDELITY SELECT HEALTH CARE	15.9	Health	Low
ARK SMALL CAP EQUITY RETAIL A**	22.2	Small-cap Growth	High	FIDELITY SELECT INSURANCE**	18.6	Financial	Average
ADVISORS INNER CIRCLE FMC SELECT**	16.7	All Cap	Very Low	FIRST AMERICAN MICROCAP Y**	25.4	Small-cap Growth	High
AMERICAN CENTURY EQUITY INC. INV.	14.4	All Cap	Very Low	FIRST EAGLE FUND OF AMERICA Y**	13.8	Mid-cap Blend	Low
AMERICAN BALANCED A	11.8	Domestic Hybrid	Very Low	FIRST GROWTH & INCOME I	14.7	Large-cap Blend	Low
AMERISTOCK	17.1	Large-cap Value	Low	FOUNTAINHEAD SPECIAL VALUE**	19.8	Mid-cap Blend	High
ARIEL**	15.8	Small-cap Value	Low	GAMERICA CAPITAL A**	18.8	Small-cap Value	Low
ARIEL APPRECIATION	17.0	Mid-cap Value	Low	GABELLI ASSET	15.0	All Cap	Low
ARMADA SMALL CAP VALUE I	15.8	Small-cap Value	Low	GABELLI EQUITY INCOME AAA**	11.7	Large-cap Value	Very Low
ATLAS ASSETS GLOBAL GROWTH A**	15.5	World	Average	GABELLI INVESTOR ABC**	9.6	Small-cap Value	Very Low
BRAZOS SMALL CAP Y	18.2	Small-cap Growth	Average	GABELLI VALUE A	18.5	Mid-cap Value	Low
BRIDGEWAY AGGRESSIVE INVESTORS I**	25.6	Mid-cap Growth	High	GALAXY SMALL CAP VALUE TRUST**	14.0	Small-cap Value	Low
BRIDGEWAY ULTRA SMALL COMPANY**	18.8	Small-cap Blend	Average	GROWTH FUND OF AMERICA A	18.1	Large-cap Growth	Average
CALAMOS GROWTH A**	26.8	All Cap	High	J. HANCOCK SMALL CAP VALUE A**	20.4	Small-cap Value	High
CALIF. INVESTMENT S&P MID CAP INDEX**	16.5	Mid-cap Blend	Average	HARTFORD CAPITAL APPRECIATION A	22.0	All Cap	Average
CLIPPER	18.2	Mid-cap Value	Very Low	HEARTLAND SELECT VALUE**	14.2	Mid-cap Value	Low
CREDIT SUISSE GLOB. HEALTH SCI. CMN.**	18.2	Health	Average	HENNESSY CORNERSTONE GROWTH**	17.2	Small-cap Growth	Average
DODGE & COX BALANCED	12.9	Domestic Hybrid	Very Low	HERITAGE CAPITAL APPREC. A**	17.7	Large-cap Growth	Average
DODGE & COX STOCK	15.6	Large-cap Value	Low	INVESCO LEISURE INV.	21.1	Miscellaneous	Low
DRESDNER RCM GLOBAL HEALTH CARE**	25.7	Health	Average	JANUS BALANCED	12.9	Domestic Hybrid	Very Low
DREYFUS MIDCAP VALUE**	18.6	Mid-cap Value	Average	JANUS CORE EQUITY	15.8	Large-cap Growth	Low
DREYFUS INDEX FUNDS MIDCAP INDEX**	15.5	Mid-cap Blend	Average	JANUS GROWTH & INCOME	15.8	Large-cap Growth	Average
EATON VANCE WLDWD. HEALTH SCIENCES A	23.4	Health	Average	JENSEN**	15.0	Large-cap Growth	Low
ENTERPRISE SMALL COMPANY VALUE A**	14.4	Small-cap Value	Very Low	KAYNE ANDRSN RUDNICK SMALL MID CAP**	13.8	Small-cap Blend	Low
EXCELSIOR VALUE & RESTRUCTURING	16.3	Large-cap Value	Average	KINETICS INTERNET**	35.9	Technology	Very High
FBR SMALL CAP FINANCIAL A**	16.2	Financial	Low	LEGG MASON EQUITY TRUST VALUE PRIM.	16.7	Large-cap Blend	Average
FMI FOCUS**	35.0	Small-cap Growth	Average	LEUTHOLD CORE INVESTMENT**	10.9	Domestic Hybrid	Very Low
FENIMORE ASSET MGMT. TR. VALUE**	14.0	Small-cap Value	Low	LIBERTY ACORN Z	15.6	Small-cap Value	Low
FIDELITY ADVISOR HEALTHCARE B**	15.7	Health	Low	LIBERTY GROWTH & INCOME B	15.0	Large-cap Value	Low
FIDELITY ADVISOR MID CAP T	18.1	Mid-cap Growth	Average	LIBERTY UTILITIES A	14.0	Utilities	Very Low
FIDELITY BALANCED	11.7	Domestic Hybrid	Very Low	LONGLEAF PARTNERS	14.8	Large-cap Value	Low
FIDELITY DIVIDEND GROWTH	15.4	Large-cap Value	Low	LORD ABBETT MID CAP VALUE A	17.7	Mid-cap Value	Low
FIDELITY EXPORT & MULTINATIONAL	17.0	Small-cap Growth	Average	MFS VALUE A	14.9	Large-cap Value	Low
FIDELITY LOW PRICED STOCK	15.1	Small-cap Value	Very Low	MS MID CAP VALUE INSTL.**	16.0	Mid-cap Blend	Average
FIDELITY MID CAP STOCK	18.7	Mid-cap Growth	Average	MAIRS & POWER BALANCED**	12.0	Domestic Hybrid	Very Low
FIDELITY SELECT AIR TRANSPORTATION**	17.4	Miscellaneous	Average	MAIRS & POWER GROWTH	15.2	Mid-cap Value	Low



of stocks expose investors to more risk. Sandi L. Gleason, co-manager of the Kayne Anderson Rudnick Small Mid Cap Fund, for instance, makes big bets on a few small and midsize companies. But companies in her portfolio are expanding earnings at a healthy 18% annual clip—even though she looks mainly for even-keeled results. “We’re not seeking the fastest-growing companies, or the cheapest,” says Gleason, whose A-rated fund has about 40 stocks, including IMS Health,

“I’m buying stocks that are paying us today, vs. trying to speculate....”

SCOTT SCHERMERHORN

Liberty Funds

a market-data company, and low-cost financial-services outfit National Commerce Financial. “We’re looking for steady growth.”

Even if their investing style is out of favor temporarily, A-rated funds often make a strong comeback in the long haul. Funds that buy health-care and biotech stocks, for example, were down an average 12.5% last year, after

whirlwind gains of 55% in 2000. So there’s a chance to buy longstanding winners, such as A-list stalwart Eaton Vance Worldwide Health Sciences fund, on the cheap. The fund has an annual 23.4%, five-year return, though it faltered with 6.6% losses last year. Manager Samuel D. Isaly balances the fund’s holdings between fledgling and mature com-

AVERAGE ANNUAL TOTAL RETURN (%)*				AVERAGE ANNUAL TOTAL RETURN (%)*			
		CATEGORY	RISK	FUND		CATEGORY	RISK
MID CAP VALUE INV.**	14.5	Mid-cap Value	Low	ROYCE PENNSYLVANIA MUTUAL INV.**	14.1	Small-cap Value	Low
5**	15.3	Large-cap Value	Low	ROYCE TOTAL RETURN**	12.5	Small-cap Value	Very Low
	10.6	Domestic Hybrid	Very Low	ROYCE TRUST & GIFTSHARES INV.**	23.1	Small-cap Value	Low
GROWTH**	15.4	All Cap	Low	SALOMON BROTHERS CAPITAL II**	17.0	All Cap	Low
VALUE	25.0	Small-cap Value	Low	SENTINEL SMALL COMPANY A**	16.9	Small-cap Value	Low
NCH ASSET BLD. MID CAP VAL. B	13.9	Small-cap Value	Low	SEQUOIA	16.5	Large-cap Value	Low
NCH HEALTHCARE B**	19.0	Health	Low	SMITH BARNEY AGGRESSIVE GROWTH A	26.3	Large-cap Growth	Average
NCH MASTER SMALL CAP VAL. B	17.8	Small-cap Growth	Average	SMITH BARNEY SECURITY & GROWTH A**	13.5	Domestic Hybrid	Low
MP	16.0	Large-cap Value	Average	S&P MIDCAP 400 DEPOSITARY RCPT.**	15.7	Mid-cap Blend	Average
GRO CAP EQUITY A**	23.0	Small-cap Growth	High	STATE STREET RESEARCH AURORA A	21.4	Small-cap Value	Low
ACON Z	12.3	Mid-cap Value	Very Low	STRONG OPPORTUNITY INV.	14.5	Mid-cap Blend	Low
DISCOVERY Z	11.8	World	Very Low	THOMPSON PLUMB BALANCED**	13.8	Domestic Hybrid	Very Low
ROPEAN Z**	15.6	Europe	Very Low	THOMPSON PLUMB GROWTH**	20.1	All Cap	Low
PERF. MID CAP GROWTH**	19.4	Mid-cap Growth	High	THORNBURG VALUE A	16.5	Large-cap Blend	Low
GROWTH**	24.6	Small-cap Growth	Average	TOUCHSTONE EMERGING GROWTH A*	21.7	Small-cap Growth	Average
BERMAN GENESIS INV.	14.2	Small-cap Value	Low	TRANSAMERICA PREMIER BALANCED INV.*	15.9	Domestic Hybrid	Low
CK PSE TECH. 100 IDX. A**	22.3	Technology	High	TURNER MID CAP GROWTH	21.4	Mid-cap Growth	High
QUITY & INCOME I**	16.8	Domestic Hybrid	Very Low	TURNER SMALL CAP VALUE**	16.6	Small-cap Value	Average
ELECT I**	26.7	Mid-cap Value	Low	TWEEDY BROWNE GLOBAL VALUE	12.9	World	Very Low
FINANCIAL ALERT C	22.6	All Cap	Average	U.S. GLOBAL LEADERS GROWTH**	14.2	Large-cap Blend	Low
ER QUEST BAL. VALUE B	15.1	Domestic Hybrid	Very Low	VAN KAMPEN COMSTOCK A	15.7	Large-cap Value	Low
5**	19.8	Mid-cap Blend	Low	VAN KAMPEN EQUITY INCOME A	13.4	Domestic Hybrid	Very Low
E CAP VALUE**	18.6	Large-cap Value	Low	VANGUARD CAPITAL OPPORTUNITY	20.7	Mid-cap Growth	High
MISSANCE C	21.4	Mid-cap Value	Low	VANGUARD HEALTH CARE	23.6	Health	Very Low
INCOME EQUITY INC.	13.9	Large-cap Blend	Very Low	VANGUARD PRIMECAP	17.0	Mid-cap Growth	Average
BALANCED	11.9	Domestic Hybrid	Very Low	VANGUARD WELLESLEY INCOME	10.0	Domestic Hybrid	Very Low
NICE CAPITAL APPRECIATION	12.1	Domestic Hybrid	Very Low	WM GROWTH FUND OF THE N.WEST A**	21.4	All Cap	Average
NICE FINANCIAL SERVICES**	16.3	Financial	Average	WADDELL & REED ADV. ACCUMULATIVE A**	15.2	Large-cap Value	Low
NICE HEALTH SCIENCES	17.7	Health	Average	WADDELL & REED ADV. SCI. & TECH. A	20.9	Technology	High
NICE MID-CAP VALUE**	13.4	Mid-cap Value	Low	WASATCH CORE GROWTH	22.3	Small-cap Blend	Average
TOTAL RETURN**	13.8	World	Low	WASATCH MICRO CAP**	34.6	Small-cap Growth	Low
AGGRESSIVE GROWTH**	26.6	Small-cap Growth	Very Low	WASATCH SMALL CAP GROWTH	22.0	Small-cap Growth	Average
IFIED GROWTH A	22.9	Small-cap Growth	High	WEITZ PARTNERS VALUE	21.6	All Cap	Very Low
IMENT VALUE EQUITY**	14.0	Large-cap Value	Low	WEITZ VALUE	21.0	All Cap	Very Low
SMALL CAP GROWTH**	20.7	Small-cap Growth	High	WELLS FARGO GROWTH BALANCED I	11.7	Domestic Hybrid	Very Low
PRICED STOCK	19.7	Small-cap Value	Average	WELLS FARGO MODERATE BALANCED I**	10.0	Domestic Hybrid	Very Low
ORTUNITY INV.**	18.7	Small-cap Value	Average	WELLS FARGO STRATEGIC INCOME I**	8.6	Domestic Hybrid	Very Low

*pretax return, appreciation plus reinvestment of dividends and capital gains Data: Standard & Poor's

**Fund data in BusinessWeek Online

JASON GROW/CORBIS SABA

Best of Breed

Rated against their peers, these funds each earned an A for five-year, risk-adjusted total returns. Not all categories have ratings, since some lack enough funds with the history needed to perform a ratings review.

FUND AVERAGE ANNUAL TOTAL RETURN (%)*

ALL CAP

CALAMOS GROWTH A**	26.8
WEITZ PARTNERS VALUE	21.6
WEITZ VALUE	21.0

DIVERSIFIED EMERGING MARKETS

DREYFUS EMERGING MARKETS **	3.9
EVERGREEN EMERGING MARKETS, GR. A**	-1.9
OPPENHEIMER DEVELOPING MARKETS A**	8.4

DIVERSIFIED PACIFIC/ASIA

MERRILL LYNCH PACIFIC B**	2.3
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DOMESTIC HYBRID

AMERICAN BALANCED A	11.8
DODGE & COX BALANCED	12.9
FIDELITY BALANCED	11.7
JANUS BALANCED	12.9
LEUTHOLD CORE INVESTMENT**	10.9
MAIRS & POWER BALANCED**	12.0
MERGER	10.6
OAKMARK EQUITY & INCOME I**	16.8
OPPENHEIMER QUEST BAL. VALUE B	15.1
PAX WORLD BALANCED	11.9
T. ROWE PRICE CAPITAL APPRECIATION	12.1
SMITH BARNEY SECURITY & GROWTH A**	13.5
THOMPSON PLUM BALANCED**	13.8
TRANSAMERICA PREMIER BALANCED INV.**	15.9
VAN KAMPEN EQUITY INCOME A	13.4
VANGUARD WELLESLEY INCOME	10.0
WELLS FARGO GROWTH BALANCED I	11.7
WELLS FARGO MODERATE BALANCED I**	10.0
WELLS FARGO STRATEGIC INCOME I**	8.6
VANGUARD LIFESTRATEGY INCOME	8.4

EUROPE

MERRILL LYNCH EUROFUND B**	9.0
MUTUAL EUROPEAN Z**	15.6

FINANCIAL

FBR SMALL CAP FINANCIAL A**	16.2
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FOREIGN

AMERICAN CENTURY INTL. DISCOVERY INV.	11.9
ARTISAN INTERNATIONAL	13.3
FIDELITY DIVERSIFIED INTERNATIONAL**	9.2
FIRST EAGLE SOGEN OVERSEAS A**	9.4
JANUS ASPEN INTL. GROWTH INSTL.	10.3
JULIUS BAER INTERNATIONAL EQUITY A**	14.0
NATIONS INTL. VALUE INV. A**	13.2
PILGRIM INTL. SMALL CAP GROWTH A**	15.6
PILGRIM INTERNATIONAL VALUE A	12.3
PUTNAM INTERNATIONAL GROWTH A	10.4
PUTNAM INTERNATIONAL VOYAGER A	12.8
SCHWAB MARKETMANAGER INTL.**	8.4
UMB SCOUT WORLDWIDE**	8.4

HEALTH

VANGUARD HEALTH CARE	23.6
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INTERNATIONAL HYBRID

CAPITAL INCOME BUILDER A	9.6
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FUND AVERAGE ANNUAL TOTAL RETURN (%)*

LARGE-CAP BLEND

FEDERATED CAPITAL APPREG. A	15.2
FIRST GROWTH & INCOME	14.7
GATEWAY	7.9
GMO U.S. CORE III	13.1
LEGG MASON EQUITY TRUST VALUE PRIM.	16.7
MASTERS SELECT EQUITY**	13.5
MOASIC EQUITY TR. INVESTORS**	12.7
PARNASSUS INCOME EQUITY INC.**	13.9
SSGA GROWTH & INCOME**	13.8
THORNBURG VALUE A	16.5
U.S. GLOBAL LEADERS GROWTH**	14.2
VICTORY DIVERSIFIED STOCK A	14.3

LARGE-CAP GROWTH

ABN AMRO CHICAGO GR. & INC. N**	13.4
AMANA GROWTH**	15.0
AMOUTH LARGE EQUITY A**	14.1
ARK CAPITAL GROWTH RETAIL A**	15.0
BRAMWELL GROWTH**	13.0
DREYFUS APPRECIATION	10.8
EATON VANCE TAX-MOD. GROWTH 1.1 B	11.6
EXETER TAX MANAGED A**	13.1
GE PREMIER GROWTH EQUITY A**	14.7
GROWTH FUND OF AMERICA A	18.1
HERITAGE CAPITAL APPRECIATION A**	17.7
HERITAGE GROWTH EQUITY A**	18.1
JANUS CORE EQUITY	15.8
JANUS GROWTH & INCOME	15.8
JENSEN**	15.0
MSF CORE GROWTH A** OAK GROWTH	15.3
SMITH BARNEY AGGRESSIVE GROWTH A	26.3
WELLS FARGO LARGE COMPANY GROWTH I	14.7
WHITENALL GROWTH SVC. **	14.5

LARGE-CAP VALUE

AIM BASIC VALUE A	16.7
AMERISTOCK GROWTH**	17.1
DODGE & COX STOCK	15.6
EXCELSIOR VALUE & RESTRUCTURING	16.3
FIDELITY DIVIDEND GROWTH	15.4
GABELLI EQUITY INCOME AAA**	11.7
LIBERTY GROWTH & INCOME B	15.0
LONGLEAF PARTNERS	14.8
MATTHEW 25**	15.3
MFS VALUE A	14.9
MUHLENKAMP	16.0
POND LARGE CAP VALUE**	18.6
SEQUOIA	16.5
VAN KAMPEN COMSTOCK A	15.7
WADDELL & REED ADV. ACCUMULATIVE A	15.2

MID-CAP BLEND

FOUNTAINHEAD SPECIAL VALUE**	19.8
OSTERWEIS**	19.8

MID-CAP GROWTH

BRIDGEWAY AGGRESSIVE INVESTOR I**	25.6
FIDELITY ADVISOR MID CAP T	18.1
FIDELITY MID CAP STOCK	18.7

AVERAGE ANNUAL TOTAL RETURN (%)

TURNER MID CAP GROWTH	21.4
VANGUARD CAPITAL OPPORTUNITY	20.7
VANGUARD PRIMECAP	17.0

MID-CAP VALUE

CLIPPER	18.2
GABELLI VALUE A	18.5
OAKMARK SELECT I	26.7
PIMCO RENAISSANCE C	21.4

MISCELLANEOUS

INVESCO LEISURE INV.	21.1
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NATURAL RESOURCES

AMERICAN GAS INDEX**	10.8
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PACIFIC/ASIA EX-JAPAN

MATTHEWS ASIAN GROWTH & INCOME**	6.5
PHOENIX ABERDEEN NEW ASIA A**	-4.1

PRECIOUS METALS

FIRST EAGLE SOGEN GOLD**	-6.9
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REAL ESTATE

SECURITY CAPITAL U.S. REAL ESTATE**	10.0
WASATCH CORE GROWTH**	19.9

SMALL-CAP BLEND

BRIDGEWAY ULTRA SMALL COMPANY**	18.8
WASATCH CORE GROWTH**	22.3

SMALL-CAP GROWTH

ARK SMALL CAP EQUITY RETAIL A**	22.2
FMI FOCUS**	35.0
FIDELITY EXPORT & MULTINATIONAL	17.0
FIRST AMERICAN MICROCAP Y**	25.4
MERRILL LYNCH MASTER SM. CAP VALUE B	17.8
NEEDHAM GROWTH**	24.6
QUAKER AGGRESSIVE GROWTH**	26.6
RE DIVERSIFIED GROWTH A	22.9
TOUCHSTONE EMERGING GROWTH A**	21.7
WASATCH MICRO CAP**	34.6
WASATCH SMALL CAP GROWTH	22.0

SMALL-CAP VALUE

CAMERICA CAPITAL A**	18.8
MERIDIAN VALUE	25.0
ROYCE LOW PRICED STOCK	19.7
ROYCE OPPORTUNITY INV.**	18.7
ROYCE TRUST & GIFTSHARES INV.**	23.1
STATE STREET RESEARCH AURORA A	21.4

TECHNOLOGY

KINETICS INTERNET**	44.2
WADDELL & REED ADV. SCI. & TECH. A	20.9

UTILITIES

LIBERTY UTILITIES A	14.0
STRONG DIVIDEND INCOME**	11.8

WORLD

ATLAS ASSETS GLOBAL GROWTH A**	15.5
MUTUAL DISCOVERY Z	11.8
PURISIMA TOTAL RETURN**	13.8
TWEEDY BROWNE GLOBAL VALUE	12.9
OPPENHEIMER GLOBAL A	14.8

*1997-2001, appreciation plus reinvestment of dividends and capital gains before taxes **Fund data in BusinessWeek Online

Data: Standard & Poor's

ies, mostly based in the U.S. He forecasts a performance surge in the next few years as the Food and Drug Administration—which dragged its heels in drug approvals last year—gets its act together. There's a record backlog of potential drugs to hit the market, he says. William McGinnis of the Touchstone Emerging Growth Fund is bullish on the health sector, betting a third of the fund's assets on biotech, health-service, and medical device stocks. His A-rated all-cap fund's annual return is 22% for five years. Investors with a contrarianist also can scour the list for global funds with solid five-year records that have hit hard times. "The biggest advantage is that [emerging] markets are less expensive," says Nicholas P. Pagen, a global strategist at J.P. Morgan Chase & Co.

He argues that although the U.S. market may be the first on its feet, Europe may zoom higher and faster, since stocks there never got as frothy. Two top European funds are Merrill Lynch Euro Fund and Mutual European. Other A-rated funds have excelled in riskier emerging markets, including the \$250 million Oppenheimer Funds Developing Markets Fund. "One cause of failure is being afraid to fail; you have to take judicious chances," says its manager, Rajeev Bhaman, who has earned an annualized 17.6%, three-year return. He too has a strong contrarian streak. Other managers are now piling into surging Russian and Chinese markets, but Bhaman sees too much political and financial volatility. Instead, he's buying utility and consumer stocks in India and Korea, where "incomes are rising and people are in consumption mode."

Since management fees come right out of an investor's pocket, it's critical to monitor them during down markets. We also track them in the Scoreboard. The average expense ratio is 1.42%. Recent S&P studies show that higher fees a fund charges, the worse it tends to perform. Although there's a growing debate about how mutual funds should be taxed in the future (page 117), investors must live with the rules for now. The Scoreboard lists untaxed capital gains—and losses—for funds. This can help investors avoid tax traps on those funds with big ex-

The Giants

Here's how *BusinessWeek* rates the largest equity funds

FUND	ASSETS \$BILIONS	OVERALL RATING	AVERAGE ANNUAL TOTAL RETURN (%)*	INVESTMENT CATEGORY	CATEGORY RATING
FIDELITY MAGELLAN	\$78.79	B	11.0	Large-cap Growth	B
VANGUARD 500 INDEX	72.49	B	10.7	Large-cap Blend	B
INVESTMENT COMPANY OF AMERICA A	54.00	B+	13.0	Large-cap Value	B+
WASHINGTON MUTUAL INVESTORS A	48.13	B+	12.2	Large-cap Value	B
GROWTH FUND OF AMERICA A	35.40	A	18.1	Large-cap Growth	A
FIDELITY GROWTH & INCOME	34.20	B+	10.4	Large-cap Blend	B+
FIDELITY CONTRAFUND	31.83	B	10.5	Large-cap Growth	B+
NEW PERSPECTIVE A	27.39	B	12.0	World	B+
EUROPACIFIC GROWTH A	26.81	C	7.4	Foreign	B+
AMERICAN CENTURY ULTRA INV.	26.45	C	9.9	Large-cap Growth	C
JANUS	25.75	C	9.5	Large-cap Growth	C
FIDELITY GROWTH COMPANY	22.40	B	13.7	Large-cap Growth	B
VANGUARD WINDSOR II INV.	22.10	B	10.4	Large-cap Value	B
VANGUARD WELLINGTON INV.	21.86	B+	10.6	Domestic Hybrid	B+
FIDELITY BLUE CHIP GROWTH	21.85	C	9.7	Large-cap Growth	B
FIDELITY EQUITY-INCOME	21.63	B	10.1	Large-cap Value	B
JANUS WORLDWIDE	21.44	C	9.8	World	B
FIDELITY PURITAN	20.19	B+	9.4	Domestic Hybrid	B+
INCOME FUND OF AMERICA A	19.74	B+	9.3	Domestic Hybrid	B
FUNDAMENTAL INVESTORS A	19.09	B+	11.7	Large-cap Blend	B+

*1997-2001, appreciation plus reinvestment of dividends and capital gains before taxes

Data: Standard & Poor's

isting gains or get a free ride on potentially well-performing funds with big carry-forward losses (page 113). Also, pre- and after-tax total returns for the past one, three, five, and ten years are provided where available. That's a useful tool to help you figure out whether you have got the appropriate funds in either taxable or tax-sheltered accounts.

The Scoreboard also gives each fund's average price-earnings ratio, a stock-valuation measure that shows how sensitive a manager is to paying steep prices. As usual, you'll find data on assets under management and sales charges. Manager changes also are highlighted: While a fund

may have had stellar results in the past five years, a departure could give an early signal of trouble ahead (page 68).

An economic recovery and a rebound from one of the worst-ever corporate profit slumps are surely in the cards. But with no clear road map to the markets so far, "it's going to be a lot tougher from

here on in," says Franklin's Winters. "You're going to have to turn over a lot of stones." *BusinessWeek* just made that process a whole lot easier. Read on.

By Mara Der Hovanesian in New York

Special Report

THE BEST MUTUAL FUNDS

The Fund Categories

Precious metals and small value shine, while growth and tech hit the skids

CATEGORY	AVERAGE ANNUAL TOTAL RETURN (%)*				CATEGORY	AVERAGE ANNUAL TOTAL RETURN (%)*			
	2001	1999-2001	1997-2001	1992-2001		2001	1999-2001	1997-2001	1992-2001
PRECIOUS METALS	19.9	1.0	-12.9	-3.3	SMALL-CAP GROWTH	-13.1	8.2	8.0	9.4
SMALL-CAP VALUE	15.3	12.3	11.2	12.5	LARGE-CAP BLEND	-13.2	-0.6	8.9	11.4
REAL ESTATE	10.1	10.3	6.4	9.4	WORLD	-17.4	2.0	6.2	9.2
MID-CAP VALUE	6.8	9.9	10.3	13.1	DIVERSIFIED PACIFIC/ASIA	-19.9	1.2	-7.4	1.0
MISCELLANEOUS	2.1	3.4	9.5	12.5	UTILITIES	-20.8	-0.5	8.2	8.7
SMALL-CAP BLEND	1.6	11.7	9.8	12.4	MID-CAP GROWTH	-20.8	6.1	9.8	11.3
DIVERSIFIED EMERGING MKTS.	-2.1	6.2	-5.1	NA	FOREIGN	-21.0	-1.4	2.2	6.1
PACIFIC/ASIA EX-JAPAN	-2.2	5.7	-7.7	4.5	LARGE-CAP GROWTH	-21.7	-2.9	8.5	10.2
FINANCIAL	-2.3	6.9	13.7	17.4	EUROPE	-22.1	-3.5	5.3	8.8
LATIN AMERICA	-4.0	8.9	0.7	3.0	JAPAN	-28.8	-2.2	-3.6	-2.7
DOMESTIC HYBRID	-4.10	2.4	7.4	9.3	COMMUNICATIONS	-34.3	-5.5	7.7	14.2
LARGE-CAP VALUE	-4.5	2.8	9.3	11.9	TECHNOLOGY	-35.7	-1.0	10.1	17.5
MID-CAP BLEND	-5.9	9.3	11.2	12.7	U.S. DIVERSIFIED EQUITY	-9.9	4.5	9.8	11.7
INTERNATIONAL HYBRID	-6.9	1.1	4.7	7.0	INTERNATIONAL EQUITY	-16.7	1.2	1.9	7.0
ALL CAP	-8.4	4.8	10.4	11.8	ALL EQUITY	-11.2	3.9	7.9	10.9
NATURAL RESOURCES	-11.4	14.7	4.5	9.9	K&P 500	-11.9	-1.0	10.7	12.9
HEALTH	-12.7	16.1	15.5	13.6					

*Appreciation plus reinvestment of dividends and capital gains before taxes

Data: Standard & Poor's

BusinessWeek online

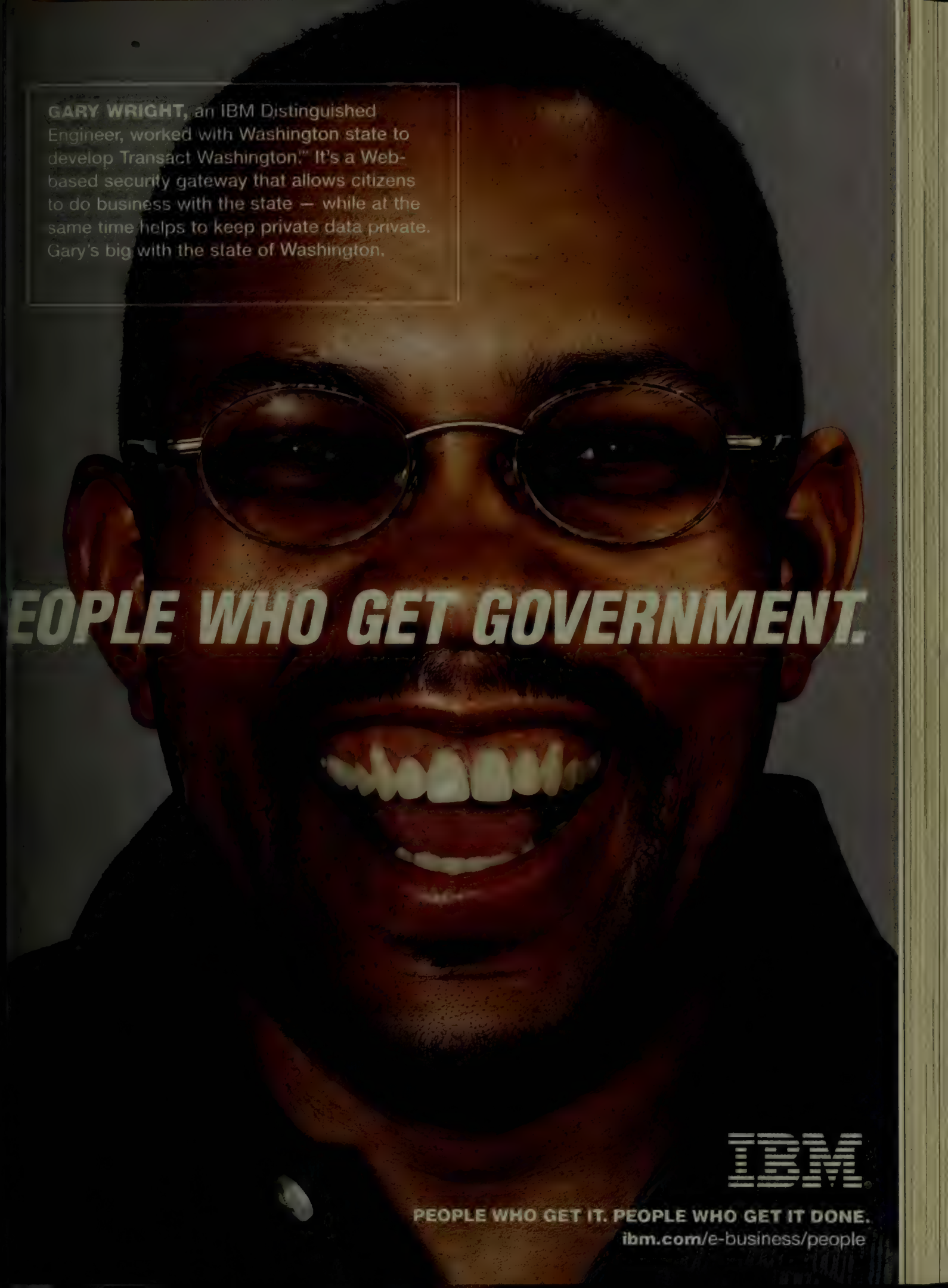
Go to our Web site at www.businessweek.com/mutual for Scoreboard ratings for an additional 2,900 funds



ULRICH STIENEN worked with Deutsche Bank to develop db-markets eTrade — a fast, reliable service that lets clients conduct foreign exchange and money market transactions online. This increased volume growth and reduced transaction costs. Danke schön, Ulrich.

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GARY WRIGHT, an IBM Distinguished Engineer, worked with Washington state to develop Transact Washington.[™] It's a Web-based security gateway that allows citizens to do business with the state — while at the same time helps to keep private data private. Gary's big with the state of Washington.

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WHEN THE MANAGER TAKES A HIKE

Relax. Most mutual funds have teams of pros—and protégés

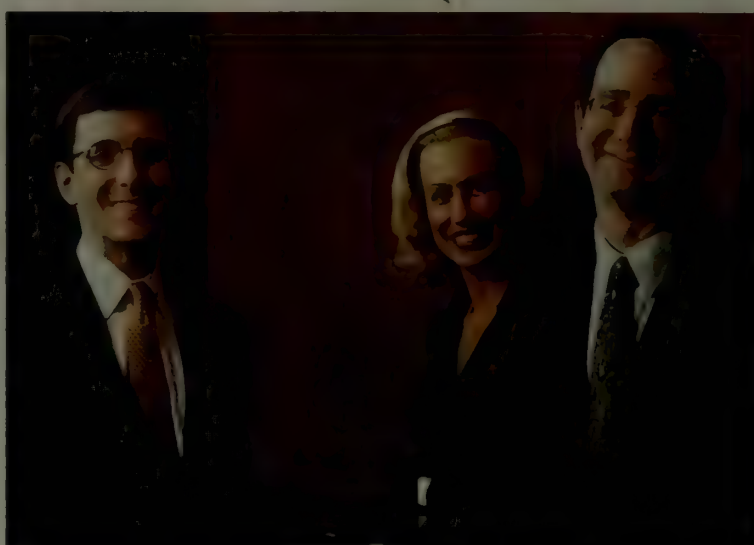
A word to the wise: Don't get overwrought about who's managing your mutual fund. That marquee name who did so well last year will probably jump to some fancy hedge fund before you know it. And the one who rode the market to the bottom could be sent packing, too.

It used to be that mutual-fund investors saw a favored manager's departure as the end of the fund's magic. But changes at the nation's largest fund companies are now routine, says William Dougherty of Kanon Bloch Carré, a Boston investment adviser. "They don't like to have any stars to shine or control the image of the fund," he says. "There's tremendous control on these people to just manage the assets and stick to the fund's mandate."

Sometimes, the arrival of new talent can look like a buying opportunity, as the Pioneer Value Fund does now. In Richard E. Dahlberg's nearly three years at the wheel, the fund's performance was mediocre. When he left in November, 2001, to join Grantham, Mayo, Van Otterloo & Co., Pioneer parachuted in one of its successful team leaders, John Carey, who has run the firm's flagship large-cap blend Pioneer Fund since 1986—boasting 10-year annualized returns of 13.7%.

Rather than jump ship at the first dip, give the new helmsman some slack to prove his or her abilities. For one thing, an overhasty departure could lead not only to regrets if the new team finds its footing but also an unnecessary tax hit from the sale of a long-term holding. It's worth sticking around for up to a year, "unless things

turn really horrendous," says Peter Di Teresa, a senior analyst at Morningstar



Since star manager Price left Mutual Series funds in '98, more vets have left, yet those remaining have done well

MUTUAL SERIES' DIAMOND, POTTO, AND WINTERS

continued to do well—four six make this year's A. Last September, when more of the original stars left, investors had the same concerns. Mutual Series promoted analysts and hired replacement managers while veteran managers Diamond, David Winters, and Susan Potto have stayed around.

But even with a carefully planned succession, the fund can be weak transition. Erin Sullivan, the former manager of Fidelity's aggressive Growth Fund, to start her own hedge fund after earning triple-digit turns in 1999. Under successor Robert C. Bertel, the fund posted a 47% drop in 2001, making it one of the worst in its class—did better.

This issue of the annual *BusinessWeek* Scoreboard

flags recent manager changes. If the manager of your mutual fund has left, don't lose your cool. Just put the fund on a watch list. Compare its performance with other prospects' in its category as the year progresses. Look at this way: You don't have to wait for your fund company to act if your fund's new manager isn't doing well. You can fire that manager and hire another one.

By Mara Der Hovanesian in New York

Fund-Manager Churn: A Plus or Minus

FUND/NEW MANAGEMENT

FIDELITY SELECT SOFTWARE Christian Zann

■ Zann, formerly of Select Natural Gas, is backed by a worldwide team of 240 analysts

PIONEER VALUE John Carey and team

■ Carey has run the flagship Pioneer Fund since 1986 with annualized 10-year returns of 13.7%

BERGER SELECT Jay Tracey

■ The firm's second worst performing fund is due to be merged in April into Tracey's Berger Growth, the sixth worst

WESTCORE SELECT Todger Anderson and William Chester

■ Anderson also runs Westcore Midco Growth, which has been beaten over 5 and 10 years by half of its peers

Data: FundAlarm.com, Morningstar Inc.

Special Report

THE BEST MUTUAL FUNDS

Inc. "But I'd keep pretty close tabs on [the fund]."

Prospects are usually worse if the departing manager was a solo act rather than part of a team. Peter Lynch, the legendary manager of Fidelity Investment's Magellan Fund, was a hard act to follow, as would be William H. Miller III if he chose to leave the A-rated Legg Mason Equity Trust Value fund. That's why many fund companies now use teams to try to ensure an orderly succession of people with the same investing philosophy.

Franklin Resources' Mutual Series Funds, for instance, were all the rage when veteran manager Michael Price ran them. He sold the funds to Franklin in November, 1996, and left active management in October, 1998. Investors' fears were assuaged when Price's protégés took the reins and con-

POSITIVE

NEGATIVE

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THE TOYOTA AVALON. WITH A CAR THIS LUXURIOUS, ONLY ONE QUESTION REMAINS—SPARKLING OR STILL?

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Equity Funds

MUTUAL FUND SCOREBOARD

How to Use the Tables

BUSINESS WEEK RATINGS

Overall ratings are based on five-year, risk-adjusted returns. They are calculated by subtracting a fund's risk-of-loss factor (see RISK) from historical pretax total return. Category ratings are based on risk-adjusted returns of the funds in that category. The ratings:

A	SUPERIOR
B+	VERY GOOD
B	ABOVE AVERAGE

C	AVERAGE
C-	BELOW AVERAGE
D	POOR
F	VERY POOR

MANAGEMENT CHANGES

Ⓐ indicates the fund's manager has held the job at least 10 years; Ⓐ indicates a change since Dec. 31, 2000.

S&P 500 COMPARISON

The pretax total returns for the Standard & Poor's 500-stock index are as follows: 2001, -11.9%; three-year average

(1999-2001); -1.02%; five-year average (1997-2001), 10.7%; 10-year average (1992-2001), 12.9%.

CATEGORY

Each U.S. diversified fund is classified by market capitalization of the stocks in the portfolio and by the nature of those stocks. If the average market cap is greater than \$10 billion, the fund is large-cap; from \$2 billion to \$10 billion, mid-cap; less than \$2 billion, small-cap. All-cap funds are those that don't follow a fixed-

capitalization policy. "Value" funds are those whose stocks have price-to-earnings ratios and price-to-book ratios lower than the average of the stocks in the category. "Growth" funds have higher than average price-to-book ratios. "Blend" funds are those in which the ratios are about average. Hybrids include stocks and bonds, and possibly other assets. World funds generally include U.S. stocks; foreign funds do not. Sector and regional funds are as indicated.

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	RATING	SIZE ASSETS \$MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	2001 RETURN PRE- TAX	AFTER- TAX
ABN AMRO MONTAG & CALDWELL GROWTH I (a)	B+	Large-cap Growth	B+	1184.9	-10	No load	0.77	-13.1	-13.1
AIM AGGRESSIVE GROWTH A	D	Small-cap Growth	C	2639.2	-27	5.50**	1.04†	-26.0	-26.0
AIM BALANCED A	C	Domestic Hybrid	D	2319.2	-5	4.75**	0.96†	-11.3	-12.0
AIM BASIC VALUE A	A	Large-cap Value	A	1863.9	514	5.50**	1.32†	0.1	0.1
AIM BLUE CHIP A	C	Large-cap Blend	D	2221.7	-24	5.50**	1.19†	-22.9	-22.9
AIM CAPITAL DEVELOPMENT A	C	Small-cap Blend	C	619.0	-8	5.50**	1.28†	-8.7	-8.7
AIM CHARTER A Ⓐ	C-	Large-cap Growth	C-	3406.9	-32	5.50**	1.06†	-23.1	-23.1
AIM CONSTELLATION A	D	All-cap	D	10583.7	-32	5.50**	1.08†	-23.6	-23.6
AIM GLOBAL HEALTH CARE A	A	Health	C	631.2	28	4.75**	1.73†	4.7	1.0
AIM INTERNATIONAL EQUITY A	D	Foreign	C-	1403.1	-33	5.50**	1.44†	-22.4	-22.4
AIM SMALL CAP GROWTH A	B+	Small-cap Growth	B+	502.2	14	5.50**	1.13†	-13.8	-13.8
AIM SUMMIT I	C-	Large-cap Growth	D	1912.5	-32	5.50	0.72	-33.8	-33.8
AIM VALUE B	C	Large-cap Growth	C	9232.2	-26	0.00**	1.77†	-13.6	-13.6
AIM WEINGARTEN A Ⓐ	D	Large-cap Growth	D	4134.7	-44	5.50**	1.03†	-34.1	-34.1
ALGER CAPITAL APPRECIATION B Ⓐ	C-	Large-cap Growth	C-	614.0	-30	0.00**	2.11†	-18.7	-18.7
ALGER LARGE CAP GROWTH B (b) Ⓐ	C	Large-cap Growth	B	614.0	-22	0.00**	1.96†	-12.9	-12.9
ALLIANCE A	D	Mid-cap Blend	F	700.5	-18	4.25**	1.04†	-18.1	-18.1
ALLIANCE GROWTH & INCOME B	B+	Large-cap Value	B+	3628.6	48	0.00**	1.67†	-2.5	-3.0
ALLIANCE GROWTH B	C-	Large-cap Growth	D	2434.1	-43	0.00**	1.97†	-25.1	-25.1
ALLIANCE PREMIER GROWTH B	C-	Large-cap Growth	C	5788.9	-34	0.00**	2.13†	-24.5	-24.5
ALLIANCE TECHNOLOGY B	D	Technology	C	3098.5	-34	0.00**	2.20†	-26.4	-26.4
AMCAP A Ⓐ	A	All-cap	B	7436.7	1	5.75**	0.67†	-5.0	-5.0
AMER. CENTURY BALANCED INV.	B	Domestic Hybrid	C	579.3	-14	No load	0.97	-3.7	-4.0
AMER. CENTURY EQUITY GROWTH INV. Ⓐ	B	Large-cap Growth	B	1481.2	-22	No load	0.67	-11.0	-11.0
AMER. CENTURY EQUITY INCOME INV.	A	All-cap	B+	765.7	129	No load	1.00	11.3	10.0
AMER. CENTURY GIFTRUST INV. Ⓐ	F	Small-cap Growth	D	921.1	-35	No load	1.00	-35.4	-35.4
AMER. CENTURY GROWTH INV.	C	Large-cap Growth	B	6280.4	-27	No load	1.00	-18.7	-18.7
AMER. CENTURY HERITAGE INV.	C	Mid-cap Growth	B	1250.0	-29	No load	1.00	-25.6	-25.6
AMER. CENTURY INCOME & GROWTH INV. Ⓐ	B	Large-cap Blend	B+	4405.3	-18	No load	0.67	-8.4	-8.4
AMER. CENTURY INTL. DISC. INV.	C	Foreign	A	1021.3	-35	0.00*	1.36	-21.8	-21.8
AMER. CENTURY INTL. GROWTH INV.	C	Foreign	B+	3317.1	-26	No load	1.20	-26.8	-26.8
AMER. CENTURY SELECT INV.	B	Large-cap Growth	B+	4988.9	-24	No load	1.00	-18.2	-18.2
AMER. CENTURY SMALL-CAP VALUE INV.	C	Small-cap Value	B	1005.3	NM	No load	1.25	30.5	29.0
AMER. CENTURY ULTRA INV.	C	Large-cap Growth	C	26453.2	-22	No load	0.99	-14.6	-14.6
AMER. CENTURY VALUE INV.	B+	All-cap	B	1809.1	28	No load	1.00	12.9	12.9
AMER. CENTURY VISTA INV.	D	Small-cap Growth	C-	1239.8	-35	No load	1.00	-27.6	-27.6
AMERICAN BALANCED A Ⓐ	A	Domestic Hybrid	A	8511.9	50	5.75**	0.69†	8.2	6.0
AMERICAN MUTUAL A Ⓐ	B+	Large-cap Value	B	8836.3	8	5.75**	0.59†	5.7	5.0
AMERISTOCK	A	Large-cap Value	A	1127.6	802	No load	0.63	2.3	2.3
ARIEL APPRECIATION Ⓐ	A	Mid-cap Value	B+	707.3	119	No load	1.26†	16.2	15.0
ARMADA EQUITY GROWTH I	B	Large-cap Growth	B+	840.4	-27	No load	0.93†	-16.3	-16.3
ARMADA LARGE CAP VALUE I (c)	B	Large-cap Value	C	679.3	5	No load	0.97†	-3.8	-5.0
ARMADA SMALL CAP VALUE I	A	Small-cap Value	B+	836.1	55	No load	1.20†	17.3	15.0
ARTISAN INTERNATIONAL	B+	Foreign	A	5259.7	19	No load	1.22	-15.9	-16.0
ARTISAN MID-CAP	B	Mid-cap Growth	B	1729.4	190	No load	1.31	-3.0	-3.0

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.

(a) Formerly Alleghany Funds: Montag & Caldwell Growth/I. (b) Formerly Alger Fund: Growth Portfolio/B. (c) Formerly Armada Equity Income Fund/I.

LOAD
of buying a fund. Many
e this "load" out of the
vestment, and for ratings
returns are reduced by
arges. Loads may be
withdrawals.

RATIO
its expenses as a per-
of average net assets for
s most recent fiscal year.
es how much sharehold-
or management. Foot-
icate the inclusion of a
plan, which spends
er money on marketing.
age is 1.42%.

TOTAL RETURN
net gain to investors, in-
vestment of dividends
al gains at month-end

TOTAL RETURN
turn adjusted for federal

taxes. Assumes ordinary income
is taxed at the 31% tax rate. Cap-
ital gains are assumed long-term
and taxed at 20%.

YIELD
Income distributions as a percent
of net asset value, adjusted for
capital-gains distributions.

HISTORY
A fund's returns relative to all
other equity funds for five one-
year periods, which, from left to
right, are 1997, 1998, 1999,
2000, and 2001. The numbers
designate which quintile the fund
was in during the period: 1 for
the top quintile, 2 for the sec-
ond, and so on. No number indi-
cates that there is no data for
that period.

TURNOVER
Trading activity, the lesser of pur-
chases or sales divided by aver-
age monthly assets.

CASH
Portion of fund assets not invest-
ed in stocks or bonds. A negative
number means the fund has bor-
rowed to buy securities.

UNTAXED GAINS
Percentage of assets in portfolio
that are unrealized and undistrib-
uted capital gains. A negative fig-
ure indicates losses that may off-
set future gains.

P-E RATIO
The average price-earnings ratio
of the fund derived from each
stock price divided by reported
per-share earnings.

TOP 10 STOCKS
The percentage of fund assets
that represents the 10 largest
holdings. The higher the number,
the more concentrated the fund,
and the more dependent on the
performance of a relatively small
number of stocks.

LARGEST HOLDING
Comes from the latest available
fund reports.

RISK
Potential for losing money in a
fund, or risk-of-loss factor. For
each fund, the three-month Trea-
sury bill return is subtracted from
the monthly total return for each
of the 60 months in the ratings
period. When a fund has not per-
formed as well as Treasury bills,
the monthly result is negative.
The sum of these negative num-
bers is divided by the number of
months. The result is a negative
number, and the greater its mag-
nitude, the higher the risk of loss.
This number is the basis for
BusinessWeek ratings, category
ratings, and the RISK column.

BEST AND WORST QUARTERS
Highest and lowest quarterly re-
turns of the past five years.

ANNUAL TOTAL RETURNS (%)					HISTORY					PORTFOLIO DATA					RISK					TELEPHONE				
FUND	5 YEARS		10 YEARS		RESULTS VS. ALL FUNDS	TURNOVER	CASH %	UNTAXED GAINS %	P/E RATIO	TOP 10 STKS. %	LARGEST HOLDING COMPANY (% ASSETS)	LEVEL	BEST		WORST		QTR	% RET	QTR	% RET				
	PRETAX	AFTERTAX	PRETAX	AFTERTAX									QTR	% RET	QTR	% RET								
1	11.7	10.6	NA	NA	111055	Low	-75	1	NA	85	Pfizer (10)	Average	IY98	27.1	I 01	-15.5					800-443-4725			
2	5.4	3.8	14.7	13.5	442255	Low	5	-11	29	17	Abercrombie & Fitch (2)	High	IY99	31.4	III 01	-24.7					800-347-4246			
3	7.2	6.1	10.6	9.5	233333	Average	2	-5	26	18	S&P 500 Futures (6)	Low	IY99	16.2	III 01	-12.2					800-347-4246			
4	16.7	16.1	NA	NA	342113	Average	7	-5	21	31	H&R Block (4)	Low	II 99	21.1	III 01	-17.3					800-347-4246			
5	8.6	8.5	10.7	9.7	113344	Low	2	-12	30	31	General Electric (5)	Average	IY98	24.5	I 01	-20.1					800-347-4246			
6	10.6	10.0	NA	NA	545577	Average	8	23	23	12	Microchip Technology (1)	High	IY99	30.9	III 98	-20.9					800-347-4246			
7	16.8	5.4	9.1	7.5	212444	Average	4	-5	27	35	General Electric (4)	High	IY98	26.1	III 01	-21.7					800-347-4246			
8	15.8	4.1	11.1	9.1	422455	Average	5	1	28	22	Microsoft (4)	High	IY99	36.6	III 01	-23.3					800-347-4246			
9	16.5	13.4	12.5	10.1	575511	High	2	24	NA	46	Tenet Healthcare (6)	Low	IY98	21.6	III 98	-11.3					800-347-4246			
10	11.4	0.9	NA	NA	551554	Average	8	-11	NA	22	Teva Pharmaceutical (3)	Average	IY99	43.1	I 01	-16.3					800-347-4246			
11	18.5	17.8	NA	NA	421333	Low	5	3	30	12	Lifepoint Hospitals (2)	High	IY99	38.1	III 01	-24.4					800-347-4246			
12	7.3	5.0	9.7	7.4	512445	Average	3	-19	31	25	Genzyme (3)	High	IY99	37.1	I 01	-30.3					800-347-4246			
13	8.8	7.1	NA	NA	212555	Average	7	-1	26	34	First Data (4)	Average	IY98	27.1	III 01	-16.0					800-347-4246			
14	3.5	1.3	8.5	4.2	212555	High	3	-41	30	26	Freddie Mac (3)	High	IY98	28.0	I 01	-27.7					800-347-4246			
15	9.9	8.6	NA	NA	511554	High	8	-46	25	45	AIG (5)	High	IY99	40.3	IY00	-26.6					800-992-3863			
16	11.5	9.2	13.4	11.6	112444	Average	7	-17	29	41	Pfizer (4)	High	IY98	25.0	III 01	-18.4					800-992-3863			
17	4.1	1.8	9.5	6.3	152444	Average	5	-3	22	30	Ebay (3)	High	IY99	26.4	III 01	-25.5					800-221-5672			
18	13.3	11.2	12.9	10.4	336112	Average	4	2	17	36	Citigroup (5)	Low	IY98	22.9	III 98	-14.1					800-221-5672			
19	4.0	1.8	10.2	8.2	212555	Average	0	-30	23	40	Tyco international (5)	High	IY98	28.6	I 01	-23.8					800-221-5672			
20	8.5	7.3	NA	NA	113355	High	1	-52	23	51	MBNA (7)	High	IY98	30.8	III 01	-20.0					800-221-5672			
21	9.6	8.7	NA	NA	511555	Low	9	-23	28	49	First Data(6)	Very High	IY99	44.3	III 01	-35.4					800-221-5672			
22	16.1	13.0	13.9	10.9	112555	Low	25	20	23	21	Medtronic (3)	Low	IY98	22.0	III 01	-15.4					800-421-0180			
23	7.0	4.6	6.8	4.7	331112	Average	6	2	17	21	S&P 500 (2)	Low	II 97	12.3	III 01	-7.8					800-345-2021			
24	9.9	8.4	12.3	10.3	123333	Average	0	0	18	27	General Electric (4)	Average	IY98	23.1	III 01	-15.4					800-345-2021			
25	14.4	11.4	NA	NA	233111	High	0	8	15	33	Union Pacific Deferred Equity (5)	Very Low	IY98	14.2	III 98	-6.2					800-345-2021			
26	2.8	-4.0	8.4	6.6	551445	Average	0	-41	28	27	Affiliated Computer Svcs. (4)	Very High	IY99	56.3	IY00	-35.1					800-345-2021			
27	10.6	7.8	8.4	5.7	212444	Average	0	-8	27	33	Pfizer (6)	Average	IY99	23.6	I 01	-19.3					800-345-2021			
28	9.5	6.9	11.1	8.8	342115	Average	0	-5	25	31	Affiliated Computer Svcs. (5)	Average	IY99	40.4	III 98	-21.2					800-345-2021			
29	10.9	9.6	13.0	11.4	112444	Average	0	5	16	26	Citigroup (3)	Average	IY98	22.2	III 01	-13.4					800-345-2021			
30	11.9	10.8	NA	NA	421333	High	0	2	NA	23	Biovail (4)	High	IY99	50.9	III 98	-19.9					800-345-2021			
31	7.8	6.0	10.3	8.6	321445	High	0	-23	NA	27	Novo Nordisk (4)	Average	IY99	48.2	III 98	-17.9					800-345-2021			
32	10.4	7.9	9.2	6.6	113344	Average	0	8	24	33	Pfizer (4)	Average	IY98	22.4	I 01	-14.6					800-345-2021			
33	NA	NA	NA	NA	5111	High	0	10	NA	20	Wisconsin Energy (3)		IY01	17.9	III 01	-8.9					800-345-2021			
34	9.9	7.5	11.6	9.6	212334	Average	5	16	20	37	Pfizer (7)	High	IY99	32.1	I 01	-17.5					800-345-2021			
35	11.9	9.3	NA	NA	342111	High	0	8	17	33	FPL Group (4)	Low	II 99	18.5	III 99	-11.0					800-345-2021			
36	4.2	2.4	7.6	5.8	551335	Average	0	-19	20	36	First Health Group (6)	High	IY99	72.2	III 98	-27.5					800-345-2021			
37	11.8	8.2	11.9	9.3	235111	Average	6	2	24	15	AT&T (2)	Very Low	II 97	10.0	III 99	-5.2					800-421-0180			
38	11.0	8.1	12.3	9.4	233331	Low	19	15	NA	18	Bank of America (3)	Very Low	IY98	12.4	III 99	-7.6					800-421-0180			
39	17.1	16.3	NA	NA	113111	Very Low	9	-24	18	43	Sara Lee (4)	Low	IY98	18.3	III 01	-10.1					800-394-5064			
40	17.0	14.9	14.2	12.4	233111	Low	6	18	NA	38	MBIA (5)	Low	IY98	23.4	III 98	-12.9					800-292-7435			
41	11.5	10.3	10.9	9.4	113344	Low	NA	25	NA	35	Pfizer (5)	Average	IY98	22.9	I 01	-16.1					800-622-3863			
42	8.8	7.4	NA	NA	233111	Average	NA	11	23	28	Fannie Mae (3)	Low	II 97	12.6	III 01	-10.8					800-622-3863			
43	15.8	13.7	NA	NA	153111	High	4	19	23	22	Arch Coal (2)	Low	IY01	19.3	III 98	-17.6					800-622-3863			
44	13.3	11.8	NA	NA	211111	Average	5	-22	NA	28	Lloyds TSB (3)	Average	IY99	49.1	III 98	-18.8					800-344-1770			
45	NA	NA	NA	NA	11112	High	9	-2	NA	26	Intuit (4)		IY99	37.7	III 01	-22.5					800-344-1770			

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	SIZE ASSETS \$MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	2001 RET. PRE- TAX
ASAF JANUS CAPITAL GROWTH B		Large-cap Growth		599.5	-44	0.00**	2.22†	-28.9
AXP BLUE CHIP ADVANTAGE A	C-	Large-cap Growth	C	1594.8	-29	5.75	0.85†	-17.0
AXP DIVERSIFIED EQUITY INCOME A	C	Large-cap Value	C-	1615.3	9	5.75	0.95†	2.7
AXP EQUITY SELECT A	C	Mid-cap Growth	B	1240.9	-15	5.75**	0.95†	-12.7
AXP EQUITY VALUE A	C	Large-cap Value	C-	1132.0	20	5.75	0.35†	-4.4
AXP GLOBAL GROWTH A	D	World	D	747.4	-39	5.75	1.22†	-22.3
AXP GROWTH A	D	Large-cap Growth	F	3288.8	-38	5.75	0.99†	-31.3
AXP MANAGED ALLOCATION A	C	International Hybrid	C	1236.3	-18	5.75	0.97†	-5.1
AXP MUTUAL A	C-	Domestic Hybrid	F	1676.2	-28	5.75	0.87†	-12.7
AXP NEW DIMENSIONS A	C	Large-cap Growth	B	12871.4	-19	5.75	1.00†	-15.5
AXP SMALL COMPANY INDEX A	C	Small-cap Value	C	652.3	13	5.75	0.87†	5.4
AXP STOCK A	C	Large-cap Blend	D-	2362.9	-22	5.75**	0.87†	-13.9
AXP STRATEGY AGGRESSIVE A	D	Mid-cap Growth	D	1014.3	-32	5.75**	1.10†	-32.9
AXP UTILITIES INCOME A	B	Utilities	C	1412.7	-15	5.75	1.03†	-23.0
BARCLAYS GLOBAL INV. S&P 500 STOCK	B	Large-cap Blend	B	1425.6	-28	No load	0.20	-12.1
BARON ASSET	C-	Small-cap Growth	B	2691.0	-45	No load	1.36†	-10.1
BEAR STEARNS S&P STARS A	B	Large-cap Blend	B+	1191.2	0	5.50**	1.50†	-13.9
BERGER GROWTH	D	Large-cap Growth	F	847.0	-38	No load	1.13†	-32.5
BERGER SMALL CAP VALUE INV.		Small-cap Value		1620.1	83	No load	1.08†	20.0
BERGER SMALL COMPANY GROWTH INV.	D	Small-cap Growth	C-	717.9	-33	No load	1.27†	-33.8
BERNSTEIN INTERNATIONAL VALUE II		Foreign		1505.4	-16	No load	1.28	-12.9
BERNSTEIN TAX MGD. INTERNATIONAL VALUE	C	Foreign	B+	2550.8	-11	No load	1.25	-12.5
BRANDYWINE	C	All-cap	C	4258.8	-23	No load	1.06	-20.6
BRAZOS SMALL CAP Y	A	Small-cap Growth	B+	850.8	-9	No load	1.03	-9.0
BRINSON TACTICAL ALLOCATION A (d)	B	Domestic Hybrid	C	952.4	13	4.50**	0.94†	-12.5
CAPITAL INCOME BUILDER A	B+	International Hybrid	A	8234.4	14	5.75**	0.67†	4.7
CAPITAL WORLD GROWTH & INC A	B+	World	B+	10345.8	-3	5.75**	0.79†	-5.0
CDC NVEST TARGETED EQUITY A (e)	C	Large-cap Blend	D	972.8	-30	5.75**	1.16†	-16.2
CLIPPER	A	Mid-cap Value	A	2468.0	119	No load	1.09	10.3
COHEN & STEERS REALTY SHARES	C	Real Estate	C	1372.3	11	No load	1.07	5.7
COLUMBIA BALANCED	B+	Domestic Hybrid	B	981.2	-10	No load	0.85	-7.4
COLUMBIA COMMON STOCK	C	Large-cap Growth	B	676.3	-23	No load	0.75	-17.6
COLUMBIA GROWTH	C	Large-cap Growth	C	1347.0	-29	No load	0.85	-21.4
COLUMBIA SPECIAL	C	Mid-cap Growth	C	775.9	-23	No load	0.99	-21.0
CONSULTING GROUP CAP. INTL. EQ.	C-	Foreign	C	667.1	-49	No load	1.03	-24.6
CONSULTING GROUP LARGE-CAP GROWTH	C-	Large-cap Growth	C-	1867.2	-15	No load	0.77	-20.7
CONSULTING GROUP LARGE-CAP VAL. EQ.	B	Large-cap Value	C	1528.0	-18	No load	0.78	-4.8
CONSULTING GRP. SMALL CAP GROWTH	D	Small-cap Growth	C-	696.4	-36	No load	1.06	-13.3
CREDIT SUISSE CAPITAL APPRECIATION CMN. (f)	B	Large-cap Growth	B+	863.5	-35	No load	0.98	-24.4
CREDIT SUISSE EMERGING GROWTH CMN. (g)	D	Mid-cap Growth	D	950.1	-45	No load	1.19	-24.8
DAVIS NY VENTURE A	B	Large-cap Value	B	10240.5	14	4.75**	0.89†	-11.4
DELAWARE DECATUR EQUITY INCOME A	C	Large-cap Value	C-	1132.5	-10	5.75**	1.12†	-3.7
DELAWARE TREND A	C	Small-cap Growth	B	732.6	-9	5.75**	1.34†	-14.9
DEUTSCHE EQUITY 500 INDEX PREMIER	B	Large-cap Blend	B	1417.4	-39	No load	0.10	-12.0
DEUTSCHE FLAG COMMUNICATIONS A (h)	C-	Communications	C	739.8	-45	5.50**	1.05†	-29.5
DEUTSCHE INTERNATIONAL EQUITY	C-	Foreign	C	813.2	-57	No load	1.50	-25.4
DODGE & COX BALANCED	A	Domestic Hybrid	A	5862.1	24	No load	0.53	10.0
DODGE & COX STOCK	A	Large-cap Value	A	8768.5	66	No load	0.54	9.3
DOMINI SOCIAL EQUITY	B	Large-cap Growth	B	1207.1	-11	No load	0.93†	-12.8
DOW INDUSTRIALS DIAMONDS		Large-cap Value		2897.6	40	No load	0.18	-4.6
DRESDNER RCM BIOTECHNOLOGY N		Health		659.1	-19	No load	1.50†	-24.7
DREYFUS	C-	Large-cap Value	F	1868.0	-17	No load	0.71	-10.1
DREYFUS APPRECIATION	B+	Large-cap Growth	A	3427.9	-12	No load	0.88	-10.7
DREYFUS BASIC S&P 500 STOCK INDEX	B	Large-cap Blend	B	1399.1	-23	No load	0.20	-12.1
DREYFUS DISCIPLINED STOCK	C	Large-cap Blend	C	2508.2	-21	No load	1.00†	-13.3
DREYFUS FOUNDERS DISCOVERY F	C	Small-cap Growth	B	802.1	-23	No load	1.25†	-17.8
DREYFUS FOUNDERS GROWTH F	D	Large-cap Growth	D	905.3	-60	No load	1.06†	-24.9
DREYFUS GR. & VAL. EMERGING LEADERS	B+	Small-cap Blend	B+	1295.2	4	0.00*	1.29	-9.9
DREYFUS GROWTH & VALUE MIDCAP VALUE	A	Mid-cap Value	B+	1210.5	375	0.00*	1.15	17.1
DREYFUS GROWTH & INCOME	C	Large-cap Value	D	1123.8	-17	No load	0.96	-6.1
DREYFUS INDEX S&P 500 INDEX	B	Large-cap Blend	C	2731.8	-5	0.00*	0.50	-12.4
DREYFUS PREMIER CORE VALUE A	B	Large-cap Value	C	878.0	13	5.75**	1.15†	-4.0
DREYFUS PREMIER TECHNOLOGY GROWTH A		Technology		542.2	-35	5.75**	1.22	-34.7
DREYFUS PREMIER THIRD CENTURY Z	C	Large-cap Growth	C	850.0	-29	No load	0.95	-23.7
DREYFUS PREMIER WORLDWIDE GROWTH B	C	World	B	743.8	-23	0.00**	1.92†	-16.6
EATON VANCE TAX-MGD. GROWTH 1.1 B (i)	B+	Large-cap Growth	A	3347.1	-12	0.00**	1.54†	-10.7
EATON VANCE WLDWD. HEALTH SCIENCES A	A	Health	B+	893.8	69	5.75**	1.69†	-6.6
ECLIPSE INDEXED EQUITY (j)	B	Large-cap Blend	B	658.4	-52	No load	0.30	-12.0
ENTERPRISE GROWTH A	B	Large-cap Growth	B	809.8	-20	4.75**	1.41†	-13.4
EUROPACIFIC GROWTH A	C	Foreign	B+	26819.2	-14	5.75**	0.84†	-12.2

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.

(d) Formerly PaineWebber Tactical Allocation Fund/A. (e) Formerly CDC Nvest Growth Fund/A. (f) Formerly Credit Suisse Warburg Pincus Cap. Apprec./Cmn. (g) Formerly Credit Suisse Warburg Pincus Emg. Growth/Cmn. (h) Formerly Flag Investors Communications/A. (i) Formerly Eaton Vance Tax Managed Growth Fund/B. (j) Formerly MainStay Instl. Funds: Index.

Equity Funds

ANNUAL TOTAL RETURNS (%)					HISTORY		PORTFOLIO DATA					RISK		TELEPHONE			
5 YRS	5 YRS	5 YRS	10 YRS	10 YRS	RESULTS VS.	TURNOVER	CASH	UNTXD	P/E	TOP 10	LARGEST HOLDING	LEVEL	BEST	WORST			
TAX	PRETAX	AFTERTAX	PRETAX	AFTERTAX	ALL FUNDS	%	GAINS %	RATIO	STKS %	COMPANY (% ASSETS)		QTR	% RET	QTR	% RET		
1.2	NA	NA	NA	NA	1235	Low	19	-69	27	55	AOL Time Warner (18)		IY99	32.5	III 01	-24.4	800-752-6342
1.4	6.5	4.7	10.7	8.8	22344	High	13	-24	25	24	S&P 500 Future (5)	Average	IY98	20.2	III 01	-16.6	800-862-7919
1.8	18.1	5.9	11.7	9.5	31311	High	2	3	NA	22	Lehman Brothers (4)	Low	IY98	15.4	III 01	-11.9	800-862-7919
1.0	11.3	8.4	12.2	9.4	22233	Average	5	-4	33	29	Whole Foods Market (3)	High	IY99	31.4	I 01	-19.4	800-862-7919
1.4	7.5	4.9	NA	NA	34422	High	2	-1	16	24	Lehman Brothers (4)	Low	IY98	16.4	III 01	-13.9	800-862-7919
1.2	2.0	0.5	5.4	4.2	52254	High	4	-47	38	24	Citigroup (3)	High	IY99	32.2	III 01	-18.4	800-862-7919
1.5	2.8	2.2	9.3	7.8	32255	Low	5	-8	41	35	Pfizer (5)	High	IY98	27.1	III 01	-28.2	800-862-7919
1.0	4.9	2.3	7.3	4.6	44432	High	10	-11	30	18	Fannie Mae 6/01 (3)	Low	IY98	12.0	III 98	-11.1	800-862-7919
1.0	1.6	-0.6	6.5	4.0	34443	Very High	5	-29	34	23	General Electric (5)	Low	IY98	10.2	III 01	-13.0	800-862-7919
1.7	10.1	8.7	12.3	10.8	21244	Low	4	18	32	33	Citigroup (5)	Average	IY98	24.3	III 01	-15.7	800-862-7919
1.3	9.3	8.0	NA	NA	35421	Average	0	2	28	7	Russell 2000 Futures (1)	Average	IY01	20.2	III 98	-21.1	800-862-7919
1.9	5.8	4.4	9.7	7.0	22433	High	5	4	31	22	General Electric (3)	Average	IY98	19.3	III 01	-12.9	800-862-7919
1.9	5.5	2.4	NA	NA	42155	Average	11	-65	41	20	Juniper Networks (3)	Very High	IY99	55.0	I 01	-28.8	800-862-7919
1.2	9.2	6.9	10.4	8.0	22414	High	4	-4	20	40	Verizon Communications (5)	Low	III 00	17.9	III 01	-10.8	800-862-7919
1.4	10.3	6.4	NA	NA	11343	Low	NA	5	31	NA		Average	IY98	20.8	III 01	-14.8	800-776-0179
1.5	7.9	7.2	13.8	13.2	14423	Very Low	0	NA	NA	62	Sothebys Holdings (9)	High	IY98	26.6	III 98	-23.5	800-992-2766
1.7	14.9	13.7	NA	NA	41223	Average	0	-10	30	38	Comcast (5)	Average	IY98	28.5	III 01	-19.7	800-766-4111
1.1	1.9	-1.7	6.4	4.0	43255	Average	0	-40	38	32	Genentech New (4)	High	IY99	42.9	IY00	-28.0	800-259-2820
1.8	NA	NA	NA	NA	1411	Average	9	18	17	23	Ross Stores (3)		IY01	24.0	III 01	-16.8	800-259-2820
1.9	5.3	5.3	NA	NA	44195	Average	1	-28	48	20	Corporate Executive Brd. (4)	Very High	IY99	59.0	III 01	-38.8	800-259-2820
NA	NA	NA	NA	NA	53	Average	1	-13	NA	19	Eni (3)		IY99	6.8	III 01	-14.4	800-221-5672
1.3	4.4	2.7	NA	NA	53333	Average	0	11	NA	19	Eni (3)	Low	I 98	18.6	III 98	-17.7	800-221-5672
1.1	7.8	4.7	13.3	10.6	45124	Very High	4	-27	23	34	Unitedhealth Group (6)	Average	IY99	32.5	III 98	-18.9	800-656-3017
1.6	18.2	17.0	NA	NA	13223	Average	1	-8	23	32	General Communication A (4)	Average	IY99	29.9	III 98	-19.5	800-426-9157
1.5	11.3	10.4	NA	NA	11333	Low	3	-2	31	25	General Electric (4)	Low	IY98	21.1	III 01	-14.9	800-647-1568
1.6	9.6	7.3	11.2	9.0	33511	Low	10	15	15	18	Philip Morris (2)	Very Low	II 97	8.9	III 99	-5.4	800-421-0180
1.2	11.0	8.6	NA	NA	43322	Low	12	-9	22	17	Philip Morris (5)	Low	IY99	16.4	III 01	-11.2	800-421-0180
1.5	8.7	5.0	9.4	6.2	31434	Very High	0	-10	28	57	Micron Technology (8)	Average	IY98	28.5	III 01	-19.5	800-225-5479
1.7	18.2	15.0	17.5	14.5	12511	Low	5	10	16	53	Freddie Mac (8)	Very Low	III 00	16.2	III 99	-4.3	800-776-5033
1.4	6.4	4.4	12.5	10.3	35511	Average	1	6	19	100	Equity Office Properties Tr. (18)	Low	II 99	12.4	III 98	-11.9	800-437-9912
1.3	8.5	6.3	10.0	7.9	32422	High	0	1	30	20	Pfizer (3)	Very Low	IY98	12.9	III 01	-8.7	800-547-1707
1.9	9.1	7.3	12.3	10.3	22334	Average	0	5	24	32	Pfizer (5)	Average	IY98	23.3	III 01	-17.4	800-547-1707
1.3	0.5	6.7	11.7	9.2	21334	High	0	4	29	39	Pfizer (7)	High	IY98	25.6	III 01	-22.0	800-547-1707
1.5	10.0	7.9	12.8	9.9	43214	High	0	-2	29	23	Biomet (3)	High	IY99	37.4	I 01	-20.3	800-547-1707
1.6	2.0	0.5	5.3	4.0	52245	Average	1	-29	20	22	Total Fina (2)	Average	IY99	28.4	III 01	-16.6	800-221-8008
1.8	7.8	5.5	9.5	8.0	21254	High	1	6	48	40	General Electric (8)	High	IY98	26.1	III 01	-22.9	800-221-8805
1.1	9.4	6.4	10.8	8.7	13522	Average	-1	6	19	21	Exxon Mobil (4)	Low	IY98	16.8	III 98	-14.1	800-221-8808
1.5	4.3	2.4	11.8	9.9	44243	Low	NA	-6	41	12	U.S. Treasury Notes (5)	Very High	IY99	36.1	III 01	-28.9	800-221-8806
1.4	11.9	9.5	13.7	11.1	12235	High	5	-16	NA	36	Microsoft (5)	Average	IY99	33.0	III 01	-23.2	800-927-2874
1.1	3.8	2.2	9.7	8.4	34245	High	3	-10	NA	26	Indymac Bancorp (4)	High	IY99	39.3	I 01	-27.8	800-927-2874
1.8	11.9	11.0	14.8	13.4	15113	Low	6	10	26	42	Tyco International (6)	Average	IY98	21.4	III 98	-14.4	800-279-0279
1.2	7.9	5.4	11.3	8.2	24522	Average	5	15	18	26	General Electric (3)	Low	II 97	13.8	III 01	-10.5	800-523-1918
1.2	13.0	10.7	14.6	12.0	11114	Low	5	-1	22	32	Partnerre (4)	High	IY99	35.0	III 01	-26.4	800-523-1918
1.3	10.6	9.3	NA	NA	11343	Average	1	7	24	23	General Electric (4)	Average	IY98	21.4	III 01	-14.7	800-730-1313
1.7	11.3	9.5	12.4	10.5	11255	Very Low	NA	-21	23	NA		High	IY98	51.2	III 01	-22.0	800-730-1313
1.7	2.2	2.0	NA	NA	42255	High	2	-31	NA	22	Eni Spa Roma Az. (3)	Average	IY99	32.1	III 01	-18.1	800-730-1313
1.5	12.9	10.2	13.4	11.2	34411	Low	3	14	22	17	U.S. Treas. Inflation Indexed Bonds (2)	Very Low	II 97	11.0	III 98	-7.9	800-621-3979
1.6	15.6	13.1	16.6	14.5	24311	Low	3	-2	15	24	Bank One (3)	Low	II 99	16.6	III 98	-14.3	800-621-3979
1.0	10.5	9.6	12.4	11.8	11343	Very Low	1	-13	23	32	Microsoft (5)	Average	IY98	24.8	III 01	-14.3	800-582-6757
1.0	NA	NA	NA	NA	332	Low	0	-14	33	45	3M (7)		IY98	17.5	III 01	-15.4	800-843-2639
1.9	NA	NA	NA	NA	11115	Very High	4	-25	49	47	Amgen (8)		IY99	65.4	I 01	-34.5	800-726-7240
1.2	4.4	2.9	6.7	4.2	42343	Average	4	16	31	26	Pfizer (3)	Average	IY98	20.3	III 01	-14.7	800-645-6561
1.8	10.8	10.2	12.2	11.6	21411	Very Low	3	31	29	45	Pfizer (8)	Low	IY98	20.5	I 01	-10.8	800-645-6561
1.7	10.4	9.9	NA	NA	11245	Very Low	1	4	30	24	General Electric (4)	Average	IY98	21.3	III 01	-14.7	800-645-6561
1.0	9.2	7.9	12.2	10.7	11343	Average	1	10	30	27	General Electric (4)	Average	IY98	22.6	III 01	-15.4	800-645-6561
1.0	13.4	11.2	13.4	11.4	43134	Average	17	-22	35	37	Cytoc (4)	High	IY99	41.9	III 01	-27.9	800-525-2440
1.9	3.5	1.2	10.0	7.4	21555	High	24	-88	26	47	Pfizer (4)	High	IY99	31.8	IY00	-25.0	800-525-2440
1.6	14.7	13.6	NA	NA	14333	Average	8	4	16	23	Pactiv (2)	Average	IY98	24.0	III 01	-18.6	800-645-6561
1.1	16.8	16.6	NA	NA	25311	Very High	0	-3	NA	20	ICN Pharmaceuticals (3)	Average	IY01	29.5	III 98	-27.7	800-645-6561
1.3	6.6	4.4	10.3	8.2	43432	Average	2	11	28	25	General Electric (3)	Average	IY98	18.5	III 01	-16.4	800-645-6561
1.9	10.1	9.7	12.4	11.3	11343	Low	3	19	30	25	General Electric (4)	Average	IY98	21.3	III 01	-14.8	800-645-6561
1.0	10.9	8.0	12.9	9.6	33255	High	3	7	25	26	Exxon Mobil (4)	Low	II 97	15.3	III 98	-14.6	800-554-4611
1.6	NA	NA	NA	NA	1155	Average	9	-72	41	42	Verizon Communications (5)		IY99	80.5	IY00	-36.4	800-554-4611
1.8	7.8	6.1	9.3	7.1	21245	Average	7	-2	32	31	Pfizer (4)	Average	IY98	24.3	III 01	-18.0	800-554-4611
1.2	7.3	7.3	NA	NA	31434	Very Low	5	7	27	32	Pfizer (4)	Average	IY98	19.9	III 01	-13.4	800-554-4611
1.0	11.6	11.6	NA	NA	12423	Very Low	3	-6	15	18	AIG (3)	Low	IY98	21.2	III 01	-14.0	800-225-6265
1.7	23.4	22.3	20.1	18.6	43312	Low	6	3	41	45	Pfizer (6)	Average	I 00	35.6	I 01	-19.3	800-225-6265
1.6	10.5	9.2	12.6	11.2	11345	Low	2	30	30	24	General Electric (4)	Average	IY98	21.5	III 01	-14.7	800-695-2126
1.8	10.9	10.0	13.9	12.3	11333	Average	6	1	30	47	Pfizer (6)	Average	IY98	26.8	I 01	-15.6	800-432-4320
1.9	7.4	5.8	10.4	9.0	21155	Low	14	6	23	18	Astrazeneca (4)	Average	IY99	29.1	III 01	-14.0	800-421-0180

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	SIZE ASSETS \$MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	2001 RET. PRE- TAX	A
EVERGREEN BALANCED A		Domestic Hybrid		847.8	-19	5.75**	0.92†	-6.4	
EVERGREEN FOUNDATION B	C	Domestic Hybrid	C-	1076.1	-24	0.00**	2.01†	-10.3	
EVERGREEN OMEGA B	C	Large-cap Growth	C	863.4	-21	0.00**	2.06†	-16.2	
EVERGREEN SMALL CO. GROWTH A		Small-cap Growth		869.3	-13	5.75**	1.05†	-17.1	
EXCELSIOR BLENDED EQUITY A	C	Large-cap Blend	C	689.1	-25	No load	0.99	-16.1	
EXCELSIOR VALUE & RESTRUCTURING	A	Large-cap Value	A	2124.2	35	No load	0.95	-5.0	
FEDERATED AMERICAN LEADERS A	B	Large-cap Value	C	1594.2	-4	5.50	1.16	-4.6	
FEDERATED CAPITAL APPRECIATION A	B+	Large-cap Blend	A	780.7	37	5.50**	1.24	-6.2	
FEDERATED EQUITY INCOME B	C	Large-cap Blend	D	1069.1	-21	0.00**	1.82†	-11.8	
FEDERATED GROWTH STRATEGIES A	C-	Mid-cap Growth	C-	708.2	-29	5.50	1.20	-22.6	
FEDERATED KAUFMANN K (k)	C	Small-cap Growth	B	3210.4	1	0.00*	1.88†	7.9	
FEDERATED MAX CAP INDEX IS (I)	B	Large-cap Blend	C	629.7	-24	No load	0.64†	-12.5	
FEDERATED STOCK TRUST	B+	Large-cap Value	B	1573.0	14	No load	0.94	0.8	
FIDELITY	B	Large-cap Growth	B+	12249.4	-18	No load	0.51	-11.2	
FIDELITY ADVISOR BALANCED T	C	Domestic Hybrid	C-	1682.4	-17	3.50**	1.15†	-1.9	
FIDELITY ADVISOR DIVIDEND GROWTH T		Large-cap Blend		1253.6	29†	3.50**	1.35†	-3.1	
FIDELITY ADVISOR EQUITY GROWTH T	C	Large-cap Growth	B	7129.9	-22	3.50**	1.26†	-18.2	
FIDELITY ADVISOR EQUITY INCOME T	B	Large-cap Value	C	2060.0	9	3.50**	1.18†	-2.4	
FIDELITY ADVISOR GROWTH & INCOME T		Large-cap Growth		1072.0	-16	3.50**	1.21†	-8.9	
FIDELITY ADVISOR GROWTH OPPORTUNITIES T	C-	Large-cap Value	F	8152.0	-41	3.50**	1.03†	-15.1	
FIDELITY ADVISOR MID CAP T	A	Mid-cap Growth	A	1404.2	11	3.50**	1.31†	-13.2	
FIDELITY ADVISOR OVERSEAS T	C-	Foreign	C	1253.8	-21	3.50**	1.57†	-20.3	
FIDELITY ADVISOR SMALL CAP T		Small-cap Growth		613.1	-2	3.50**	1.53†	-3.9	
FIDELITY ADVISOR TECHNOLOGY B	D	Technology	C-	834.9	-35	0.00**	1.96†	-27.4	
FIDELITY ADVISOR VALUE STRATEGIES T	B	Mid-cap Value	C	667.4	66	3.50**	1.14†	12.1	
FIDELITY AGGRESSIVE GROWTH	D	Large-cap Growth	F	7439.0	-49	0.00*	0.89	-47.3	
FIDELITY ASSET MANAGER	B+	Domestic Hybrid	B	11905.1	-7	No load	0.71	-3.9	
FIDELITY ASSET MANAGER GROWTH	B	Domestic Hybrid	C	4209.1	-12	No load	0.78	-7.2	
FIDELITY ASSET MANAGER INCOME	B+	Domestic Hybrid	B+	936.1	18	No load	0.52	1.3	
FIDELITY BALANCED	A	Domestic Hybrid	A	6828.3	15	No load	0.64	2.2	
FIDELITY BLUE CHIP GROWTH	C	Large-cap Growth	B	21859.4	-18	No load	0.87	-16.6	
FIDELITY CAPITAL APPRECIATION	C	Large-cap Blend	C-	2268.5	-12	No load	0.91	-7.6	
FIDELITY CONTRAFUND I	B	Large-cap Growth	B+	31836.6	-19	3.00	0.84	-12.6	
FIDELITY CONTRAFUND II		Large-cap Growth		1072.7	-27	3.00	0.91	-9.6	
FIDELITY DISCIPLINED EQUITY	B	Large-cap Growth	B+	2965.5	-11	No load	0.84	-14.2	
FIDELITY DIVERSIFIED INTERNATIONAL	B	Foreign	A	6125.4	-1	0.00*	1.16	-13.0	
FIDELITY DIVIDEND GROWTH	A	Large-cap Value	A	14388.3	27	No load	0.94	-3.7	
FIDELITY EQUITY INCOME	B	Large-cap Value	B	21636.2	1	No load	0.57	-5.0	
FIDELITY EQUITY INCOME II	B	Large-cap Value	B	12032.9	-10	No load	0.63	-7.2	
FIDELITY EUROPE	C	Europe	B	1137.0	-14	0.00*	0.99	-16.0	
FIDELITY EXPORT & MULTINATIONAL	A	Small-cap Growth	A	830.8	29	0.00*	0.81	0.7	
FIDELITY GROWTH & INCOME	B+	Large-cap Blend	B+	34202.3	-14	No load	0.66	-9.3	
FIDELITY GROWTH COMPANY	B	Large-cap Growth	B	22409.6	-23	No load	0.85	-25.3	
FIDELITY INDEPENDENCE (m)	C	Large-cap Growth	C	5485.4	-31	No load	0.85	-27.2	
FIDELITY INTERNATIONAL GROWTH & INC.	C-	Foreign	B+	829.3	-21	0.00*	1.09	-17.4	
FIDELITY LARGE CAP STOCK	C	Large-cap Growth	B	647.5	-26	No load	0.93	-17.7	
FIDELITY LOW PRICED STOCK I	A	Small-cap Value	B+	11402.4	79	3.00*	1.00	26.7	
FIDELITY MAGELLAN	B	Large-cap Growth	B	78790.2	-15	3.00	0.80	-11.7	
FIDELITY MID CAP STOCK	A	Mid-cap Growth	A	6272.7	1	0.00*	0.84	-12.8	
FIDELITY NEW MILLENNIUM	B+	Small-cap Growth	B+	2828.4	-16	3.00	0.89	-18.2	
FIDELITY OTC	D	Large-cap Growth	D	8087.4	-31	No load	0.94	-24.1	
FIDELITY OVERSEAS	C-	Foreign	C	3582.6	-23	0.00*	1.12	-20.2	
FIDELITY PURITAN	B+	Domestic Hybrid	B+	20190.6	-3	No load	0.53	-1.1	
FIDELITY REAL ESTATE INVESTMENT	C	Real Estate	B	1186.4	26	0.00*	0.62	8.5	
FIDELITY SELECT BIOTECHNOLOGY	A	Health	C	3330.9	-19	3.00*	1.00	-25.0	
FIDELITY SEL. COMPUTERS	D	Technology	C	1155.7	-47	3.00*	0.95	-27.3	
FIDELITY SEL. DEVELOP. COMMUNICATIONS	C-	Communications	C	826.5	-55	3.00*	0.90	-36.1	
FIDELITY SEL. ELECTRONICS	C	Technology	B	5023.1	-23	3.00*	0.87	-14.7	
FIDELITY SEL. HEALTH CARE	A	Health	C	2651.2	-11	3.00*	0.97	-15.0	
FIDELITY SEL. SOFTWARE & COMPUTER	C	Technology	B+	926.0	-16	3.00*	0.99	-7.0	
FIDELITY SEL. TECHNOLOGY	C-	Technology	B	2698.1	-41	3.00*	0.94	-31.7	
FIDELITY SMALL CAP INDEPENDENCE (n)	C	Small-cap Growth	B	855.8	37	0.00*	0.74	5.3	
FIDELITY SMALL CAP STOCK		Small-cap Growth		1243.8	17	0.00*	1.05	5.4	
FIDELITY SPARTAN 500 INDEX	B	Large-cap Blend	B	8466.3	-11	0.00*	0.19	-12.1	
FIDELITY SPARTAN TOTAL MARKET INDEX		Large-cap Growth		1067.8	5	0.00*	0.25	-10.8	
FIDELITY STOCK SELECTOR	C	Large-cap Growth	C	1079.7	-26	No load	0.63	-14.4	
FIDELITY TREND	C-	Large-cap Growth	C-	894.8	-20	No load	0.52	-12.4	
FIDELITY UTILITIES	C	Utilities	C	1413.9	-38	No load	0.78	-15.2	
FIDELITY VALUE	B	Mid-cap Value	C	4956.8	55	No load	0.77	12.2	
FIDELITY WORLDWIDE	C	World	C	794.7	-14	0.00*	1.05	-6.2	

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.

(k) Formerly Kaufmann Fund. (l) Formerly Federated Max-Cap Fund/Instl. Serv. (m) Formerly Fidelity Retirement Growth Fund. (n) Formerly Fidelity Small Cap Selector.

Equity Funds

ANNUAL TOTAL RETURNS (%)					HISTORY	PORTFOLIO DATA					RISK					TELEPHONE	
RANK	5 YEARS		10 YEARS		RESULTS VS. ALL FUNDS	TURNOVER	CASH %	UNTAXED GAINS %	P/E RATIO	TOP 10 STKS. %	LARGEST HOLDING COMPANY (% ASSETS)	LEVEL	BEST		WORST		
	PRETAX	AFTERTAX	PRETAX	AFTERTAX									QTR	% RET	QTR	% RET	
4	NA	NA	NA	NA	432	High	9	0	24	28	Freddie Mac TBA (4)		IX 99	10.5	III 01	-7.8	800-343-2898
0	5.8	4.4	NA	NA	33433	Average	16	2	23	41	U.S. Treas. Bonds 08/01 (5)	Low	IX 99	11.5	I 01	-9.4	800-343-2898
3	9.9	8.1	NA	NA	22244	High	3	-33	27	29	Tyco International (4)	High	IX 99	28.9	IX 00	-25.7	800-343-2898
1	NA	NA	NA	NA	144	High	1	-20	30	27	Roper Industries (5)		IX 99	47.5	III 98	-29.3	800-343-2898
3	5.8	8.7	12.7	11.5	21334	Average	NA	37	19	34	Exxon Mobil (5)	Average	IX 98	22.6	III 01	-15.4	800-448-1012
8	16.3	16.0	NA	NA	14222	Low	NA	13	18	23	AmerisourceBergen (3)	Average	IX 99	26.0	III 98	-20.5	800-448-1012
6	10.0	8.1	12.6	10.7	12532	Low	0	12	23	20	Tyco International (2)	Low	IX 98	16.1	III 01	-12.4	800-341-7400
1	15.2	13.6	15.1	13.4	12232	High	0	2	17	19	Healthsouth (2)	Average	IX 99	27.6	III 98	-15.3	800-341-7400
5	5.4	4.4	NA	NA	23443	High	0	-2	23	23	General Electric (3)	Average	IX 98	16.0	IX 00	-13.8	800-341-7400
9	9.5	7.5	10.7	8.4	23154	Average	0	-16	NA	16	BJ's Wholesale Club (2)	High	IX 99	42.0	IX 00	-20.9	800-341-7400
2	11.3	8.0	15.0	13.1	44321	Low	12	30	29	46	Lincare Holdings (7)	Average	IX 99	35.8	III 98	-18.7	800-341-7400
1	9.9	9.3	NA	NA	11343	Low	0	32	37	25	General Electric (4)	Average	IX 98	21.1	III 01	-14.8	800-341-7400
0	11.7	9.2	13.6	11.0	12521	Low	2	18	19	20	Tyco International (3)	Low	IX 98	16.5	III 01	-11.8	800-341-7400
1	11.2	9.3	13.5	11.2	11343	High	NA	-10	NA	NA	Sun Microsystems	Average	IX 98	23.8	III 01	-18.3	800-522-7297
4	6.4	4.5	7.7	5.0	33532	High	1	-4	26	24	General Electric (4)	Low	II 97	12.6	III 01	-8.2	800-522-7297
9	NA	NA	NA	NA	412	High	0	0	35	38	Cardinal Health (6)		IX 01	11.3	III 01	-12.6	800-522-7297
4	11.1	9.3	NA	NA	31244	Average	0	-9	22	31	Microsoft (6)	Average	IX 98	24.1	III 01	-22.1	800-522-7297
5	10.0	8.2	NA	NA	23522	High	0	12	20	23	Exxon Mobil (4)	Low	IX 98	17.8	III 98	-12.3	800-522-7297
3	NA	NA	NA	NA	1544	Average	0	-2	38	31	General Electric (5)		IX 98	23.4	III 01	-15.7	800-522-7297
7	2.8	1.3	10.0	8.5	22554	High	0	-4	27	31	General Electric (6)	Average	IX 99	20.5	III 01	-16.6	800-522-7297
1	18.1	16.5	NA	NA	23213	High	0	0	19	29	Freddie Mac (4)	Average	IX 99	28.3	III 01	-21.9	800-522-7297
7	2.7	1.6	6.7	5.9	43254	Average	10	5	NA	NA	Sanofi-Synthelabo	Average	IX 99	25.0	III 01	-18.4	800-522-7297
9	NA	NA	NA	NA	152	Low	0	4	33	35	American Italian Pasta (4)		IX 98	36.4	III 01	-22.3	800-522-7297
4	9.4	8.4	NA	NA	51155	High	7	-43	NA	NA	Hewlett-Packard	Very High	IX 99	49.0	III 01	-38.9	800-522-7297
8	13.5	11.3	12.8	10.0	24321	Low	0	9	23	33	WMS Industries (7)	Average	IX 01	30.1	III 01	-28.7	800-522-7297
4	5.9	3.3	10.5	8.3	31155	High	NA	-45	51	37	Ciena (8)	Very High	IX 99	48.3	III 01	-40.3	800-522-7297
8	9.7	7.0	10.6	8.4	24432	High	0	2	19	36	S&P 500 Index Futures (8)	Very Low	IX 98	14.1	III 01	-7.8	800-522-7297
4	8.8	8.1	11.6	9.6	22432	High	0	-13	19	31	Cardinal Health (5)	Low	IX 98	16.1	III 01	-11.1	800-522-7297
7	6.6	4.6	NA	NA	11521	High	38	-5	20	52	S&P 500 Index Futures (6)	Very Low	II 97	5.7	III 01	-2.2	800-522-7297
4	11.7	9.0	10.3	8.0	22431	High	5	-4	24	21	Fannie Mae 30 yr. MB Pool	Very Low	IX 98	12.7	III 01	-6.8	800-522-7297
0	9.7	8.8	13.1	11.4	21344	Low	2	-5	NA	31	General Electric	Average	IX 98	23.4	III 01	-18.4	800-522-7297
1	10.3	8.6	13.5	11.3	22232	High	2	8	NA	35	Dell Computer	High	IX 99	29.8	III 01	-21.4	800-522-7297
3	10.5	8.2	14.3	12.1	31333	High	8	-3	24	18	Exxon Mobil (3)	Low	IX 98	23.7	I 01	-13.2	800-522-7297
1	NA	NA	NA	NA	333	High	5	-20	24	33	Microsoft (7)		IX 99	33.8	III 01	-16.0	800-522-7297
5	10.5	8.1	12.5	10.2	12333	Average	3	-8	NA	24	General Electric	Average	IX 98	21.0	III 01	-13.8	800-522-7297
2	9.2	8.2	10.1	9.2	32244	Average	7	-6	NA	15	Vodafone	Low	IX 99	30.4	III 98	-14.5	800-522-7297
3	15.4	13.5	NA	NA	21412	High	4	-4	23	39	Cardinal Health	Low	IX 98	19.5	III 01	-12.7	800-522-7297
7	10.1	8.3	13.6	11.7	23422	Low	2	-4	NA	25	Fannie Mae	Low	IX 98	16.2	III 98	-12.9	800-522-7297
3	10.2	7.4	13.6	11.1	32322	Very High	0	7	20	30	Exxon Mobil (5)	Low	IX 98	20.8	III 01	-13.4	800-522-7297
6	6.1	4.4	10.2	8.8	32344	High	4	-14	NA	31	Marschallink Laut	Average	IX 99	21.7	III 01	-18.2	800-522-7297
9	17.0	13.4	NA	NA	32221	High	8	3	49	45	Cardinal Health	Average	IX 99	29.4	III 01	-14.8	800-522-7297
9	10.4	8.9	13.8	11.8	11433	Average	11	-4	NA	30	General Electric (4)	Low	IX 98	20.5	I 01	-10.9	800-522-7297
8	13.7	11.9	14.3	12.5	31133	Average	0	-10	42	24	Microsoft (5)	High	IX 99	44.5	I 01	-26.5	800-522-7297
8	11.9	8.6	12.3	8.6	31233	Very High	0	-26	13	58	Philip Morris (17)	High	IX 99	35.7	I 01	-24.9	800-522-7297
5	5.1	3.8	7.5	6.4	54144	Average	12	-10	NA	18	Total Fina Average	IX 99	29.4	III 98	-17.4800-522-7297		
3	6.3	7.9	NA	NA	21244	High	4	-17	73	28	Microsoft	Average	IX 98	23.5	III 01	-19.0	800-522-7297
4	15.1	12.8	17.9	15.3	24511	Average	16	6	NA	11	D.R. Horton (2)	Very Low	IX 01	16.5	III 98	-16.8	800-522-7297
2	11.0	9.6	12.9	10.6	21343	Low	0	10	21	32	General Electric (5)	Average	IX 98	27.2	III 01	-15.4	800-522-7297
3	18.7	16.5	NA	NA	21112	High	15	0	NA	13	Advent Software	Average	IX 99	28.5	III 01	-24.7	800-522-7297
1	20.8	17.6	NA	NA	21134	Average	0	2	28	33	QLogic (6)	High	IX 99	53.7	III 01	-28.3	800-522-7297
2	8.1	6.2	11.9	9.5	51155	Very High	2	-4	NA	37	Microsoft (16)	High	IX 99	46.2	III 01	-32.0	800-522-7297
7	3.1	1.9	6.1	4.7	43254	Average	13	-19	NA	24	Vodafone	Average	IX 99	25.1	III 01	-18.4	800-522-7297
3	9.4	7.1	12.1	9.3	33522	Average	3	-6	NA	24	Fannie Mae 30 yr. MB Pool	Very Low	IX 99	12.7	III 01	-6.8	800-522-7297
7	7.1	5.2	11.3	9.5	35511	Average	10	-3	20	50	Equity Office Properties (10)	Low	III 97	13.6	III 98	-11.5	800-522-7297
4	21.5	19.3	11.9	10.4	31115	Average	6	-2	NA	57	Amgen	High	IX 99	40.7	I 01	-34.8	800-544-8888
7	12.5	8.5	21.2	18.1	51155	Average	7	-61	NA	34	Microsoft	Very High	IX 99	41.7	III 01	-37.1	800-544-8888
8	12.2	9.0	15.8	12.6	51155	High	5	-157	NA	50	AT&T	Very High	IX 99	53.5	IX 00	-37.4	800-544-8888
0	20.1	16.8	28.0	25.0	41154	Average	10	-35	NA	39	Intel	Very High	IX 98	56.8	III 01	-37.4	800-544-8888
8	15.9	13.5	13.7	11.2	11514	Average	NA	24	NA	59	Pfizer	Low	II 97	21.4	I 01	-18.2	800-544-8888
3	19.1	15.8	22.6	19.5	41152	High	10	-20	NA	48	Microsoft	Very High	IX 99	57.1	III 01	-41.1	800-544-8888
1	15.5	12.2	18.2	15.1	31155	Average	12	-97	134	46	Microsoft	Very High	IX 99	62.1	III 01	-38.3	800-544-8888
0	8.6	7.6	NA	NA	25421	Very High	9	16	43	23	FTI Consulting	Average	II 97	17.4	III 98	-24.5	800-522-7297
8	NA	NA	NA	NA	211	Average	12	10	NA	26	Venator Group		IX 98	21.6	III 98	-26.5	800-522-7297
8	10.5	9.8	12.6	11.8	11343	Very Low	0	7	41	24	General Electric	Average	IX 98	21.4	III 01	-14.9	800-544-8544
1	NA	NA	NA	NA	2322	Very Low	0	-15	36	19	General Electric		IX 98	22.0	III 01	-16.0	800-544-8544
8	8.2	5.9	12.1	9.8	23334	High	8	-8	45	23	General Electric	Average	IX 98	19.7	III 98	-15.9	800-522-7297
8	5.0	3.2	9.0	6.7	54233	Very High	1	-7	27	26	Microsoft	High	IX 99	24.9	III 98	-27.0	800-522-7297
4	7.7	4.9	9.8	7.4	11354	High	0	-37	NA	64	BellSouth	Average	IX 98	18.5	IX 00	-18.3	800-522-7297
3	9.8	7.5	14.3	12.1	34421	Low	7	0	NA	12	American Standard	Average	II 99	25.6	III 98	-20.1	800-522-7297
4	6.3	4.8	9.9	8.6	44232	High	4	-4	NA	27	Cardinal Health	Average	IX 98	20.4	III 98	-21.2	800-522-7297

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	SIZE ASSETS \$MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	2001 RET. PRE- TAX	AFT- TAX
FIRST AMERICAN INTERNATIONAL Y (o)	C-	Foreign	B-	700.7	1497	No load	1.65	-23.4	-23
FIRST EAGLE SOGEN GLOBAL A	B+	International Hybrid	B+	1518.4	-6	5.00	1.35†	7.4	7
FIRST GROWTH & INCOME I	A	Large-cap Blend	A	688.9	-14	No load	0.97	-12.3	-13
FIRSTHAND TECHNOLOGY VALUE	D	Technology	C	1477.9	-49	0.00*	1.83	-44.0	-44
FORTIS GROWTH A	C-	Mid-cap Growth	C	649.7	-26	4.75**	1.04†	-24.1	-24
FRANKLIN BALANCE SHEET INVEST. A	B+	Small-cap Value	C	1823.4	55	5.75**	1.08†	17.7	16
FRANKLIN BIOTECHNOLOGY DISCOVERY A	B+	Health	B+	363.5	-24	5.75**	1.09†	+20.5	+20
FRANKLIN CALIFORNIA GROWTH A	C	Mid-cap Growth	C	1443.5	-27	5.75**	0.89†	-23.2	-23
FRANKLIN GROWTH A	B	Large-cap Value	C	1871.3	-11	5.75**	0.91†	-9.5	-9
FRANKLIN GROWTH & INCOME A	C	Large-cap Growth	C	856.2	-8	5.75**	0.90†	-23.1	-23
FRANKLIN INCOME A	B	Domestic Hybrid	C	6187.6	6	4.25**	0.73†	0.7	-1
FRANKLIN SMALL-CAP GROWTH II A	C-	Small-cap Growth	C-	816.6	186	5.75**	1.32†	-3.3	-3
FRANKLIN SMALL MID-CAP GROWTH A (p)	C-	Mid-cap Growth	C-	8117.9	-19	5.75**	0.86†	-20.5	-20
FRANKLIN UTILITIES A	C	Utilities	C	1320.8	-17	4.25**	0.79†	-8.1	-10
FREMONT GLOBAL	C	International Hybrid	C-	629.8	-14	No load	0.90	-10.3	-10
FREMONT U.S. MICRO CAP	B+	Small-cap Growth	B+	853.3	-2	No load	1.57	5.3	5
FUNDAMENTAL INVESTORS A	B+	Large-cap Blend	B+	13099.6	-1	5.75**	0.64†	-9.5	-10
GABELLI ASSET	A	All-cap	B	1643.3	-3	No load	1.36†	0.2	-0
GABELLI GROWTH	B	Large-cap Growth	B+	2998.9	-22	No load	1.38†	-24.1	-24
GABELLI VALUE A	A	Mid-cap Value	A	1216.7	6	5.50	1.36†	5.4	4
GALAXY EQUITY GROWTH TRUST	B	Large-cap Blend	B	950.8	-16	No load	0.92	-18.6	-18
GALAXY II LARGE CO. INDEX RETAIL	B	Large-cap Blend	B	818.9	-15	No load	0.47	-12.2	-13
GARTMORE TOTAL RETURN D (q)	C	Large-cap Blend	C	1599.4	-18	4.50	0.78	-11.9	-12
GATEWAY	B+	Large-cap Blend	A	1254.8	-21	No load	0.98†	-3.5	-3
GEORGE PUTNAM OF BOSTON A	B	Domestic Hybrid	C	3149.0	1	5.75**	0.92†	0.5	-0
GLENMEDE INTERNATIONAL	C	Foreign	B-	1270.6	-14	No load	0.11	-13.9	-14
GMO INTERNATIONAL INTRINSIC VALUE III (r)	C-	Foreign	B-	1133.3	-21	No load	0.69†	-12.1	-13
GMO US CORE III	B+	Large-cap Blend	A	1253.0	-20	No load	0.48†	-7.7	-8
GOLDMAN SACHS CAPITAL GROWTH A	B	Large-cap Growth	B+	1990.0	-18	5.50**	1.42†	-15.2	-15
GOLDMAN SACHS INTL. EQUITY A	C-	Foreign	C	914.4	-22	5.50**	1.79†	-22.7	-22
GROWTH FUND OF AMERICA A	A	Large-cap Growth	A	35402.0	-2	5.75**	0.71†	-12.3	-12
GUARDIAN PARK AVENUE A	C-	Large-cap Growth	C-	1793.8	-29	4.50	0.79	-21.7	-21
JOHN HANCOCK FINANCIAL IND. B	C	Financial	C	1526.3	-24	0.00**	2.05†	-18.5	-18
JOHN HANCOCK LARGE CAP VALUE A	B+	Large-cap Value	B	765.1	2	5.00**	1.14†	-3.4	-4
JOHN HANCOCK REGIONAL BANK B	C	Financial	D	1965.7	-8	0.00**	2.07†	1.6	-0
JOHN HANCOCK SMALL CAP GROWTH A	D	Small-cap Growth	C	712.2	-11	5.00**	1.28†	-14.2	-14
JOHN HANCOCK SOVEREIGN INVESTOR A	B	Large-cap Value	C	1217.8	-13	5.00**	1.08†	-6.1	-8
HARBOR CAPITAL APPRECIATION	C	Large-cap Growth	B	8745.0	-14	No load	0.64	-17.7	-17
HARBOR INTERNATIONAL	C	Foreign	B+	3663.7	-22	No load	0.92	-12.3	-13
HARTFORD ADVISERS A	B+	Domestic Hybrid	B	1148.0	28	5.50**	1.21†	-5.2	-5
HARTFORD CAPITAL APPRECIATION A	A	All-cap	B+	1764.1	45	5.50**	1.27†	-6.7	-6
HARTFORD MID-CAP A	C	Mid-cap Growth	C	880.4	57	5.50**	1.43†	-4.7	-4
HARTFORD STOCK A	B	Large-cap Blend	B+	1127.3	9	5.50**	1.27†	-13.7	-13
HEARTLAND VALUE	B+	Small-cap Value	C	1006.4	12	No load	1.22†	26.5	26
ICAP EQUITY	B+	Large-cap Value	B+	1108.4	9	No load	0.80	-0.6	-0
IDEX JANUS GROWTH A (s)	C-	Large-cap Growth	D	879.7	-38	5.50**	1.40†	-26.3	-28
INCOME FUND OF AMERICA A	B+	Domestic Hybrid	B	19745.6	11	5.75**	0.62†	5.4	3
INVESCO BALANCED INV.	B	Domestic Hybrid	C-	950.1	-2	No load	1.07†	-11.5	-12
INVESCO DYNAMICS INV.	C-	Mid-cap Growth	C	5900.6	-22	No load	1.00†	-32.9	-32
INVESCO EQUITY INCOME INV.	B	Large-cap Value	C	3439.5	-17	No load	0.98†	-11.8	-12
INVESCO FINANCIAL SERVICES INV.	B+	Financial	C	1292.8	-7	No load	1.25†	-10.2	-11
INVESCO GROWTH INV. (t)	F	Large-cap Growth	F	984.0	-44	No load	1.16†	-49.1	-49
INVESCO HEALTH SCIENCES INV.	B	Health	C-	1754.5	-12	No load	1.23†	-14.7	-14
INVESCO LEISURE INV.	A	Miscellaneous	A	887.4	24	No load	1.36†	4.1	3
INVESCO SMALL COMPANY GROWTH INV.	C-	Small-cap Growth	C	1245.3	-7	No load	1.29†	-20.9	-20
INVESCO TECHNOLOGY INV.	D	Technology	C-	2022.2	-43	No load	0.98†	-45.5	-45
INVESCO TELECOMMUNICATIONS INV.	D	Communications	C-	903.4	-83	No load	1.10†	-54.2	-54
INVESCO TOTAL RETURN INV.	B	Domestic Hybrid	C-	1266.4	-31	No load	1.27†	-0.8	-2
INVESTMENT COMPANY OF AMERICA A	B+	Large-cap Value	B+	54008.1	-1	5.75**	0.56†	-4.6	-5
ISHARES RUSSELL 2000 INDEX	C	Small-cap Blend	C	2004.7	733	No load	0.20	2.0	1
ISHARES RUSSELL 3000 INDEX	C	Mid-cap Blend	C	1468.6	413	No load	0.20	-11.8	-12
ISHARES S&P 500 INDEX	C	Large-cap Blend	C	3408.5	83	No load	0.09	-12.0	-12
JANUS	C	Large-cap Growth	C	25757.0	-36	No load	0.84	-26.1	-26
JANUS ADVISER BALANCED	C	Domestic Hybrid	C	666.2	151	No load	1.17†	-4.8	-5
JANUS ADVISER WORLDWIDE GROWTH	C	World	C	1087.8	132	No load	1.20†	-21.1	-21
JANUS ASPEN CAP APPRECIATION INSTL.	C	Large-cap Growth	C	752.5	-23	No load	0.67	-21.7	-22
JANUS ASPEN GROWTH INSTL.	C	Large-cap Growth	C	2446.9	-31	No load	0.67	-24.7	-24
JANUS ASPEN INTERNATIONAL GROWTH INSTL.	C	Foreign	A	850.8	-25	No load	0.71	-23.2	-23
JANUS ASPEN WORLDWIDE GROWTH INSTL.	B	World	B+	5610.8	-27	No load	0.69	-22.4	-22
JANUS BALANCED	A	Domestic Hybrid	A	4461.1	-4	No load	0.85	-5.0	-5

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.

(o) Formerly Firststar International Growth Fund/Instl. (p) Formerly Franklin Strategic Shares: Sm. Cap Growth I/A. (q) Formerly Nationwide Fund/D. (r) Formerly GMO Tr. International. (s) Formerly IDEX: JCC Growth Fund/A. (t) Formerly INVESCO Blue Chip Growth Fund/Inv.

Equity Funds

ANNUAL TOTAL RETURNS (%)					HISTORY	PORTFOLIO DATA					RISK					TELEPHONE	
FUND	5 YEARS		10 YEARS		RESULTS VS. ALL FUNDS	TURNOVER	CASH %	UNTAXED GAINS %	P/E RATIO	TOP 10 STKS. %	LARGEST HOLDING COMPANY (% ASSETS)	LEVEL	BEST		WORST		
	PRETAX	AFTERTAX	PRETAX	AFTERTAX									QTR	% RET	QTR	% RET	
2.1	3.9	2.5	NA	NA	52245	Average	6	-12	18	21	Vodafone (2)	Average	IX 99	27.6	III 98	-17.0	800-677-3863
2.2	8.8	6.3	10.9	8.8	55321	Very Low	1	14	NA	28	Buderus (6)	Very Low	II 99	9.2	III 98	-11.0	800-451-3623
2.3	14.7	12.7	NA	NA	12323	Low	NA	19	NA	NA		Low	IX 98	20.6	III 01	-11.6	800-442-1941
2.4	14.0	12.9	NA	NA	52145	Low	12	-182	31	47	Peoplesoft (8)	Very High	IX 98	60.6	I 01	-41.8	888-883-3863
2.5	10.3	6.6	9.4	6.8	42125	High	5	-1	54	24	GE Capital Master Variable (4)	High	IX 99	43.9	I 01	-23.9	800-800-2000
2.6	11.8	10.6	15.3	13.7	25511	Very Low	15	22	13	36	Overseas Shipholding Group (3)	Very Low	II 99	17.6	III 98	-13.6	800-342-5236
2.7	NA	NA	NA	NA	31114	Low	6	-15	47	42	Amgen (7)		IX 99	61.3	I 01	-32.2	800-342-5236
2.8	12.3	11.6	17.4	15.9	43135	Very Low	1	-4	35	23	Mattel (3)	High	IX 99	56.4	I 01	-26.0	800-342-5236
2.9	9.0	8.2	10.9	10.2	32423	Very Low	8	40	26	31	Tyco International (3)	Low	IX 01	14.0	III 01	-15.4	800-342-5236
2.8	11.1	9.5	11.9	9.7	23125	Low	7	7	28	23	Philip Morris (2)	High	IX 99	37.2	III 01	-21.3	800-342-5236
2.6	7.3	4.5	9.6	6.7	44511	Low	13	-4	13	33	Philip Morris (7)	Very Low	III 00	9.0	III 01	-4.6	800-342-5236
2.8	NA	NA	NA	NA	2	Low	NA	-7	24	NA			IX 01	26.9	III 01	-26.0	800-342-5236
2.0	10.3	9.9	NA	NA	44144	Very Low	15	3	26	27	Affiliated Computer Services A (2)	High	IX 99	59.8	III 01	-25.1	800-422-5236
2.4	8.3	6.0	7.9	5.7	24512	Low	2	15	15	48	Exelon (9)	Low	III 00	26.7	I 99	-11.4	800-342-5236
2.2	4.4	2.2	7.3	5.2	31111	Average	10	-18	21	17	Freddie Mac (2)	Low	IX 99	16.0	III 01	-11.4	800-548-4539
2.6	18.9	16.0	NA	NA	54141	Average	22	-8	24	42	Endocare (4)	High	IX 99	49.7	III 98	-29.0	800-548-4539
2.9	11.7	9.4	13.9	11.5	23323	Average	6	-12	28	19	Dow Chemical (2)	Low	IX 98	15.5	III 01	-15.5	800-421-0180
2.8	15.0	12.7	14.8	12.7	13332	Average	0	32	16	22	Telephone & Data Systems (4)	Low	IX 98	18.2	III 98	-14.2	800-422-3554
2.5	12.9	10.8	12.6	10.2	11245	Average	0	-21	23	44	Pfizer (7)	Average	IX 98	30.2	III 01	-22.3	800-422-3554
2.0	18.5	16.0	17.2	14.3	12231	Average	3	21	16	37	Viacom A (6)	Low	II 97	21.3	III 01	-14.6	800-422-3554
2.6	10.9	8.8	11.9	10.3	12334	Average	NA	13	39	NA		Average	IX 98	24.2	III 01	-17.2	
2.7	10.3	8.9	12.5	11.2	11343	Low	NA	14	42	NA		Average	IX 98	21.2	III 01	-14.7	
2.4	9.4	7.0	10.8	8.4	11533	Average	1	2	25	27	Fannie Mae (5)	Average	II 97	18.5	III 01	-14.1	800-848-0920
2.4	7.9	6.9	7.9	6.8	43422	Low	0	-3	37	25	General Electric (4)	Very Low	IX 98	7.2	III 01	-7.3	800-354-5525
2.7	8.0	6.0	10.3	7.9	33521	Very High	6	2	24	NA	Exxon Mobil	Very Low	II 97	9.6	III 99	-7.0	800-225-1581
2.0	4.2	2.7	8.6	6.8	53343	Low	NA	-16	17	NA		Low	IX 98	15.5	III 01	-13.2	800-442-8299
2.7	2.6	0.3	7.1	5.1	53422	Low	NA	-11	12	NA		Low	I 98	16.7	III 98	-15.1	
2.2	13.1	8.3	14.0	9.9	12332	High	5	-1	21	20	Fannie Mae (3)	Low	IX 98	19.5	III 01	-11.8	
2.2	12.5	10.7	14.4	11.7	11334	Low	2	4	25	29	Microsoft (5)	Average	IX 98	24.3	III 01	-16.5	800-621-2550
2.9	1.5	-0.1	NA	NA	12244	Average	2	-7	22	22	GlaxoSmithKline (4)	Average	IX 99	21.7	I 01	-15.0	800-621-2550
2.3	18.1	15.7	15.5	13.6	21223	Low	16	9	31	23	AOL Time Warner (3)	Average	IX 98	27.2	III 01	-20.6	800-421-0180
2.8	8.3	4.2	12.7	10.4	12254	High	6	-18	22	32	Johnson & Johnson (4)	High	IX 99	25.1	I 01	-20.5	800-221-3253
2.1	NA	NA	NA	NA	4514	Average	1	15	NA	44	AIG (6)		III 00	22.7	III 98	-20.2	800-257-3338
2.5	15.4	13.0	13.8	11.5	13232	High	0	-9	NA	48	Sprint (6)	Average	IX 99	31.7	III 01	-24.0	800-257-3336
2.3	9.8	7.9	16.2	16.5	14511	Very Low	3	56	NA	28	Washington Mutual (3)	Average	III 00	20.4	III 98	-16.5	800-257-3336
2.5	7.6	5.5	11.5	10.4	43133	Average	3	-7	29	13	Secure Computing (1)	Very High	IX 99	43.9	III 01	-26.5	800-257-3336
2.8	9.1	7.0	10.1	8.3	23522	Average	6	25	NA	34	Baxter International (4)	Low	IX 98	15.6	III 98	-7.9	800-257-3326
2.8	12.4	10.1	14.2	12.2	11244	Average	4	-19	26	32	Citigroup (4)	High	IX 98	30.0	III 01	-19.5	800-422-1050
2.7	5.7	4.0	10.9	9.6	43333	Very Low	4	34	NA	29	BP (4)	Average	IX 98	18.3	III 98	-16.6	800-422-1050
2.3	9.9	8.9	NA	NA	32422	Low	0	-5	37	21	U.S. Treas. Bonds 08/01 (3)	Very Low	II 97	12.4	III 01	-7.3	800-800-2000
2.1	22.0	20.5	NA	NA	14122	High	0	-2	NA	25	Northrop Grumman (4)	Average	IX 99	36.8	III 98	-21.9	800-800-2000
2.1	NA	NA	NA	NA	2312	Average	0	-1	NA	20	Mattel (2)		IX 99	29.8	III 01	-17.9	800-800-2000
2.4	11.6	11.2	NA	NA	11333	Average	0	-14	24	31	Microsoft (5)	Average	IX 98	20.3	III 01	-14.5	800-800-2000
2.2	12.8	10.4	17.1	15.1	23511	Average	8	33	14	34	Fannie Mae 07/01 (8)	Low	II 99	21.7	III 98	-18.6	800-432-7856
2.7	12.4	10.9	NA	NA	23422	High	3	15	NA	34	Citigroup (4)	Low	II 97	17.2	III 98	-17.5	888-221-4227
2.0	9.3	7.4	10.0	8.1	41155	Low	9	-23	35	50	AOL Time Warner (11)	High	IX 99	31.8	III 01	-31.7	800-421-4339
2.0	9.3	6.5	11.2	8.5	34521	Average	11	3	22	14	Philip Morris (3)	Very Low	IX 98	8.2	III 98	-4.9	800-421-0180
2.4	7.3	5.7	NA	NA	32433	Average	3	-15	24	23	U.S. Treas. Notes 08/02 (4)	Low	IX 98	13.7	III 01	-12.5	800-525-8085
2.7	10.2	8.8	13.1	10.8	32122	Low	4	-36	34	19	Forest Labs (3)	High	IX 99	38.6	III 01	-35.0	800-525-8085
2.8	8.4	5.9	9.7	7.2	23423	Low	1	19	28	26	J.P. Morgan Chase (3)	Low	II 97	13.3	III 01	-13.5	800-525-8085
2.2	13.5	11.4	17.1	14.4	13513	Average	3	15	17	43	Citigroup (5)	Average	III 00	22.8	III 98	-18.2	800-525-8085
2.2	-0.7	-3.5	5.3	2.1	21255	High	0	-133	42	43	AOL Time Warner (5)	Very High	IX 01	34.5	III 01	-43.2	800-525-8085
2.9	12.9	10.1	10.0	7.9	41514	High	1	7	41	47	Pfizer (7)	Average	I 98	16.9	I 01	-22.9	800-525-8085
2.7	21.1	18.6	18.0	15.8	31191	Low	5	19	24	47	Harrah's Entertainment (8)	Low	IX 99	25.6	III 01	-24.1	800-525-8085
2.8	11.4	8.6	14.0	11.7	43144	Average	14	-29	23	26	Province Healthcare (2)	High	IX 99	46.7	III 01	-28.7	800-525-8085
2.3	7.9	5.2	14.1	11.7	51155	Average	4	27	24	24	Flextronics International (3)	Very High	IX 99	86.8	III 01	-41.4	800-525-8085
2.7	8.5	7.8	NA	NA	10195	Low	9	16	NA	38	Bellsouth (4)	Very High	IX 99	62.2	III 01	-41.4	800-525-8085
2.3	6.0	4.6	9.4	8.0	70597	Average	6	9	17	26	Fannie Mae Benchmark Notes (3)	Very Low	II 97	11.9	III 99	-8.4	800-525-8085
2.2	13.0	10.7	13.1	11.0	22422	Low	15	-1	20	21	Philip Morris (3)	Low	IX 98	17.3	III 01	-10.2	800-421-0180
2.8	NA	NA	NA	NA	1	Low	NA	0	19	NA			IX 01	20.3	III 01	-20.6	800-776-0179
2.8	NA	NA	NA	NA	3	Very Low	NA	-2	24	NA			IX 01	11.1	III 01	-15.4	800-776-0179
2.8	NA	NA	NA	NA	3	Very Low	NA	-13	25	NA			IX 01	10.6	III 01	-14.7	800-776-0179
2.0	9.5	7.4	11.1	9.0	31245	Average	2	-11	44	43	AOL Time Warner (10)	High	IX 98	28.4	III 01	-25.8	800-525-3713
2.4	NA	NA	NA	NA	1332	High	14	-4	34	28	Citigroup (3)		IX 98	19.1	III 01	-5.6	800-525-3713
2.8	NA	NA	NA	NA	1144	Average	20	-16	36	31	Tyco International (4)		IX 99	42.1	III 01	-19.5	800-525-3713
2.0	NA	NA	NA	NA	1154	Low	9	-44	35	46	AOL Time Warner (7)		IX 99	41.8	III 01	-18.7	800-525-3713
2.2	9.0	8.1	NA	NA	31245	Low	10	-33	47	47	AOL Time Warner (11)	Average	IX 98	27.7	III 01	-24.8	800-525-3713
2.0	10.3	9.8	NA	NA	42145	Average	19	-33	31	24	NTT DoCoMo (4)	Average	IX 99	58			

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	SIZE ASSETS \$MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	2001 RETURN PRE- TAX	AFTER TAX
JANUS CORE EQUITY (u)	A	Large-cap Growth	A	788.7	-17	No load	0.83	-12.1	-12.1
JANUS ENTERPRISE	D	Mid-cap Growth	D	3227.1	-47	No load	0.88	-39.9	-39.9
JANUS GLOBAL LIFE SCIENCES		Health		2442.6	-37	No load	0.94	-18.1	-18.1
JANUS GLOBAL TECHNOLOGY		Technology		2522.1	-55	No load	0.90	-40.0	-40.0
JANUS GROWTH & INCOME	A	Large-cap Growth	A	6983.9	-17	No load	0.88	-14.4	-14.4
JANUS MERCURY	C	All-cap	C	8385.6	-36	No load	0.88	-29.8	-29.8
JANUS OLYMPUS	B	All-cap	C	3377.3	-47	No load	0.90	-32.1	-32.1
JANUS ORION		Large-cap Blend		662.0	-25	No load	1.12	-14.7	-14.7
JANUS OVERSEAS	C	Foreign	B+	5257.8	-37	No load	0.88	-23.1	-23.1
JANUS SPECIAL SITUATIONS	B+	Large-cap Growth	B+	1024.6	-28	No load	0.94	-16.0	-16.0
JANUS STRATEGIC VALUE		Large-cap Blend		2080.1	-27	No load	0.99	-11.7	-11.7
JANUS TWENTY	C	Large-cap Growth	C	15300.3	-42	No load	0.65	-29.2	-29.2
JANUS VENTURE	D	Small-cap Growth	C	1100.3	-25	No load	0.66	-11.9	-11.9
JANUS WORLDWIDE	C	World	B	21449.7	-37	No load	0.88	-22.9	-22.9
LEGG MASON EQ. TR. SPECIAL INVMNT. PRIM.	B	Small-cap Blend	B	2118.6	-5	No load	1.79†	2.3	1.7
LEGG MASON EQ. TR. VALUE PRIM.	A	Large-cap Blend	A	9706.6	-10	No load	1.68†	-9.3	-9.3
LEGG MASON INV. TR. OPPORTUNITY TR. PRIM.		All-cap		1661.9	72	0.00**	1.98†	1.9	1.9
LIBERTY A	C	Domestic Hybrid	C-	795.1	-4	5.75**	1.10†	-9.5	-10.2
LIBERTY ACORN INTERNATIONAL Z (v)	C-	Foreign	B	1675.2	-31	No load	1.05	-21.1	-21.1
LIBERTY ACORN Z (w)	A	Small-cap Value	B+	3992.0	10	No load	0.83	6.1	5.7
LIBERTY GROWTH & INCOME B	A	Large-cap Value	A	915.4	12	0.00**	2.07†	-1.2	-2.0
LIBERTY UTILITIES A	A	Utilities	A	680.9	52	4.75**	1.15†	-8.6	-11.1
LONGLEAF PARTNERS	A	Large-cap Value	A	4166.0	17	No load	0.93	10.3	9.9
LONGLEAF PARTNERS INTERNATIONAL		Foreign		775.2	102	No load	1.79	10.8	8.7
LONGLEAF PARTNERS SMALL CAP	B+	Small-cap Value	B	1618.5	25	No load	0.98	5.4	3.4
LORD ABBETT AFFILIATED A	B+	Large-cap Value	B	10041.1	1	5.75**	0.79†	-7.9	-9.1
LORD ABBETT DEVELOPING GROWTH A	C-	Small-cap Growth	C	982.2	-17	5.75**	1.11†	-7.0	-7.0
LORD ABBETT MID CAP VALUE A	A	Mid-cap Value	B+	1148.4	126	5.75**	1.35†	8.0	6.8
MAINSTAY CAPITAL APPRECIATION B	C-	Large-cap Growth	C	2027.1	-31	0.00**	1.74†	-24.5	-24.5
MAINSTAY EQUITY INDEX A	B	Large-cap Blend	C	948.7	-16	3.00**	0.92†	-12.8	-13.4
MAINSTAY TOTAL RETURN B	C	Domestic Hybrid	C-	1159.6	-21	0.00**	1.88†	-12.6	-13.3
MAINSTAY VALUE B	C	Large-cap Value	D	746.7	-5	0.00**	1.95†	-2.4	-2.6
MAIRS & POWER GROWTH	A	Mid-cap Value	B+	656.3	20	No load	0.78	11.5	5.4
MANAGERS SPECIAL EQUITY	C	Small-cap Blend	C	2159.2	9	No load	1.26	-8.1	-8.1
MARSICO FOCUS		Large-cap Blend		1421.0	-38	No load	1.30†	-20.8	-20.8
MARSICO GROWTH & INCOME		Large-cap Blend		599.8	-26	No load	1.33†	-20.3	-20.4
MASSACHUSETTS INVESTORS GROWTH STK. A	B+	Large-cap Growth	B+	8398.2	-9	5.75**	0.65†	-24.8	-24.8
MASSACHUSETTS INVESTORS TRUST A	C	Large-cap Blend	C-	5765.1	-23	5.75**	0.87†	-16.2	-16.1
MERCURY HW INTL. VALUE I (x)	C	Foreign	B+	815.6	-49	5.25**	1.06	-12.8	-14.3
MERGER	A	Domestic Hybrid	A	1060.7	-8	No load	1.34†	2.0	0.1
MERIDIAN VALUE	A	Small-cap Value	A	989.9	401	No load	1.10	11.7	11.6
MERRILL LYNCH BALANCED CAPITAL B	C	Domestic Hybrid	C-	1341.0	-30	0.00**	1.61†	-5.9	-7.3
MERRILL LYNCH BASIC VALUE B	B	Large-cap Value	B	2496.4	-14	0.00**	1.57†	-1.5	-3.4
MERRILL LYNCH FUNDAMENTAL GROWTH B	B	Large-cap Growth	B+	2271.8	-19	0.00**	1.81†	-20.2	-20.2
MERRILL LYNCH GLOBAL ALLOCATION B	B+	International Hybrid	B+	2845.8	-25	0.00**	1.90†	1.0	0.1
MERRILL LYNCH GLOBAL GROWTH B		World		929.4	-47	0.00**	1.95†	-27.1	-27.1
MERRILL LYNCH GLOBAL VALUE B	C	World	B	919.7	-36	0.00**	1.92†	-14.6	-15.1
MERRILL LYNCH MASTER SMALL CAP VALUE B	A	Small-cap Growth	A	841.7	66	0.00**	2.05†	29.3	27.9
MFS CAPITAL OPPORTUNITIES A	C	Large-cap Blend	C-	2805.0	-10	5.75**	1.11†	-24.9	-24.9
MFS EMERGING GROWTH A	D	Large-cap Growth	F	4636.6	-29	5.75**	1.09†	-25.8	-25.8
MFS GROWTH OPPORTUNITIES A	C-	Large-cap Growth	D	696.1	-36	5.75**	0.80†	-24.7	-24.7
MFS MID CAP GROWTH A	C	Mid-cap Growth	B	1164.0	96	5.75**	1.26†	-19.9	-19.9
MFS NEW DISCOVERY A		Small-cap Growth		1091.4	39	5.75**	1.52†	-5.1	-5.1
MFS RESEARCH A	C-	Large-cap Blend	D	2411.1	-26	5.75**	0.89†	-21.6	-21.6
MFS STRATEGIC GROWTH A	B	Large-cap Growth	B+	1146.8	4	5.75**	1.37†	-25.1	-25.1
MFS TOTAL RETURN A	B+	Domestic Hybrid	B+	4344.8	25	4.75**	0.88†	-0.6	-2.1
MFS UTILITIES B	B	Utilities	B	958.1	-11	0.00**	1.73†	-25.6	-25.9
MFS VALUE A (y)	A	Large-cap Value	A	1199.2	452	5.75**	1.21†	-7.8	-8.0
J.P. MORGAN DISCIPLINED EQUITY INSTL. (z)		Large-cap Blend		1123.9	-20	No load	0.45	-11.7	-11.9
J.P. MORGAN GROWTH & INC. A (aa)	C	Large-cap Value	D	870.5	-17	5.75	1.30†	-13.5	-13.7
MPAM INCOME STOCK (ab)		Large-cap Blend		598.8	-28	No load	0.77	-9.7	-11.0
MPAM LARGE CAP STOCK (ac)		Large-cap Blend		1820.6	-23	No load	0.75	-13.2	-13.5
MPAM MID CAP STOCK (ad)		Mid-cap Blend		860.4	15	No load	0.85	-1.9	-2.0
MS AGGRESSIVE EQUITY B (ae)		Large-cap Growth		747.1	-46	0.00**	1.94†	-30.7	-30.7
MS AMERICAN OPPORTUNITY B (af)	C	Large-cap Growth	B	6307.2	-39	0.00**	1.28†	-27.3	-27.5
MS BEST IDEA B (ag)		World		773.0	-45	0.00**	1.82†	-24.6	-24.6
MS DIVIDEND GROWTH SECS. B (ah)	C	Large-cap Value	C-	10010.6	-14	0.00**	1.42†	-9.2	-10.3
MS EUROPEAN GROWTH B (ai)	C	Europe	B+	1329.3	-37	0.00**	2.05†	-18.4	-18.6
MS GLOBAL DIVIDEND GROWTH SECS. B (aj)	C	World	C	1679.9	-22	0.00**	1.90†	-7.2	-7.4
MS GLOBAL UTILITIES B (ak)	B+	Utilities	B	625.8	-34	0.00**	1.74†	-24.3	-24.7

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.

(u) Formerly Janus Equity Income Fund. (v) Formerly Acorn Invest Trust: International. (w) Formerly Acorn Invest Trust: Acorn Fund. (x) Formerly Hotchkiss & Wiley Fds: International. (y) Formerly MFS Equity Income Fund/A. (z) Formerly J.P. Morgan Institutional Disciplined Equity Fd. (aa) Formerly Chase Vista Growth and Income Fund/A. (ab) Formerly MPAM In Fund. (ac) Formerly MPAM Large Cap Stock Fund. (ad) Formerly MPAM Mid Cap Stock Fund. (ae) Formerly Morgan Stanley Dean Witter Aggressive Eqty./B. (af) Formerly Morgan S

Equity Funds

ANNUAL TOTAL RETURNS (%)					HISTORY	PORTFOLIO DATA					RISK	TELEPHONE					
FUND	5 YEARS		10 YEARS		RESULTS VS. ALL FUNDS	TURNOVER	CASH %	UNTAXED GAINS %	P/E RATIO	TOP 10 STKS. %	LARGEST HOLDING COMPANY (% ASSETS)	LEVEL	BEST		WORST		
	PRETAX	AFTERTAX	PRETAX	AFTERTAX									QTR	% RET	QTR	% RET	
10	15.8	14.5	NA	NA	111111	High	6	-9	30	28	Citigroup (6)	Low	IV 98	26.6	III 01	-14.5	800-525-3713
9	6.5	5.4	NA	NA	411155	Low	4	-122	50	34	Ebay (5)	Very High	IV 99	57.9	I 01	-32.7	800-525-3713
7	NA	NA	NA	NA	1114	High	16	-24	44	32	Baxter International (4)	Very High	IV 99	31.3	I 01	-26.3	800-525-3713
2	NA	NA	NA	NA	153	Low	17	-79	59	24	Microsoft (5)	Very High	IV 99	74.0	III 01	-36.2	800-525-3713
9	15.8	14.3	14.4	12.7	111244	Low	7	0	34	29	Citigroup (4)	Average	IV 99	29.2	III 01	-15.9	800-525-3713
16	13.5	11.5	NA	NA	411155	Average	7	-56	40	39	Nokia (7)	High	IV 99	42.7	I 01	-24.3	800-525-3713
7	16.2	15.6	NA	NA	211155	Average	3	-35	46	31	Goldman Sachs Group (4)	High	IV 99	51.7	I 01	-26.3	800-525-3713
NA	NA	NA	NA	NA	4	Average	24	-76	41	49	Fannie Mae (7)	High	IV 01	22.8	IV 00	-27.2	800-525-3713
2	8.0	9.0	NA	NA	411155	Average	5	-11	28	26	Tyco International (5)	High	IV 99	60.6	III 01	-20.8	800-525-3713
12	14.1	12.7	NA	NA	112154	Average	8	-21	26	49	Viacom (7)	Average	IV 98	28.5	III 01	-25.6	800-525-3713
NA	NA	NA	NA	NA	2	Average	7	-13	24	44	El Paso (8)	High	IV 01	16.9	III 01	-22.3	800-525-3713
12	12.2	10.9	11.8	9.9	111155	Low	38	-9	34	61	AOL Time Warner (13)	High	IV 99	38.4	IV 00	-25.4	800-525-3713
1	8.8	5.8	10.4	7.6	231155	Average	10	-3	NA	27	Enzon (4)	Very High	IV 99	82.8	IV 00	-30.2	800-525-3713
9	9.8	8.6	13.6	12.4	271142	Average	8	-11	28	27	NTT Docomo (5)	Average	IV 99	42.1	III 01	-20.8	800-525-3713
9	12.9	11.1	13.7	12.2	323331	Low	1	26	25	51	Republic Services A (8)	Average	IV 98	40.1	III 01	-26.3	800-368-2558
4	16.7	15.0	18.2	15.8	110141	Average	2	5	25	49	United Health Group (7)	Average	IV 98	35.9	III 01	-20.0	800-368-2558
NA	NA	NA	NA	NA	31	Low	1	-7	NA	46	Cabletron Systems (8)	High	IV 01	22.8	III 01	-29.5	800-368-2558
9	5.0	4.3	10.2	7.7	234333	Low	4	1	22	20	Fannie Mae 6.5% (3)	Low	II 97	15.6	I 01	-8.8	800-426-3750
5	5.5	4.0	NA	NA	331154	Average	15	-5	NA	26	Serco Group (2)	Average	IV 99	41.6	III 01	-18.8	800-922-8789
1	15.8	13.0	15.6	14.2	242221	Low	7	35	16	20	AmeriCredit (3)	Low	IV 98	21.9	III 98	-19.5	800-922-8789
5	15.0	12.5	NA	NA	124112	High	2	9	16	32	Aetna (4)	Low	IV 98	21.4	III 98	-14.2	800-426-3750
7	14.0	11.3	12.5	10.3	224113	High	1	4	13	41	AT&T (6)	Very Low	IV 97	14.6	I 99	-5.4	800-426-3750
16	14.8	11.8	17.3	14.6	185111	Low	6	11	21	59	Marriott International (9)	Low	IV 98	18.5	III 98	-18.4	800-445-9469
3	NA	NA	NA	NA	311	Average	10	-1	NA	58	Nippon Fire & Marine (9)	High	II 99	15.7	III 01	-7.7	800-445-9469
8	12.5	10.6	14.0	12.4	220111	Low	19	4	14	62	Fleming (7)	Low	IV 98	14.5	III 98	-13.4	800-445-9469
3	12.2	9.7	14.0	11.1	230112	Average	0	16	29	23	Exxon Mobil (4)	Low	IV 98	17.1	III 01	-14.0	800-201-6984
4	8.4	7.4	11.9	9.7	142352	Low	0	7	29	17	Timberland (2)	High	IV 98	28.3	III 01	-22.5	800-201-6984
8	17.7	14.8	15.8	12.7	155111	Average	0	16	50	30	Boston Scientific (4)	Low	II 99	17.6	III 98	-17.3	800-201-6984
6	7.1	5.7	10.9	10.0	313333	Low	3	12	35	35	Tyco International (4)	High	IV 98	26.9	I 01	-20.1	800-624-6782
6	10.5	9.8	12.8	11.9	113343	Low	0	8	30	24	General Electric (4)	Average	IV 98	25.3	III 01	-14.9	800-624-6782
9	7.3	5.4	8.6	7.2	224340	High	2	12	35	18	Tyco International (2)	Low	IV 98	16.9	I 01	-11.6	800-624-6782
7	5.5	3.8	10.6	8.9	334322	High	3	2	21	34	Citigroup (4)	Average	II 99	13.2	III 98	-16.6	800-624-6782
4	15.2	13.9	17.3	16.0	244111	Very Low	0	36	19	46	TCF Financial (5)	Low	II 97	19.0	III 98	-13.2	800-304-7404
10	11.5	10.4	14.4	12.6	241332	Average	10	2	19	16	Clipper Fund (2)	High	IV 99	35.9	III 01	-23.7	800-835-3879
4	NA	NA	NA	NA	11154	High	4	-8	28	45	Citigroup (5)	High	IV 99	34.8	I 01	-18.6	888-860-8686
8	NA	NA	NA	NA	11044	High	1	0	26	41	Microsoft (5)	High	IV 99	35.0	III 01	-17.5	888-860-8686
2	15.0	12.7	13.7	10.4	112353	Very High	5	-29	29	22	Tyco International (4)	Average	IV 99	28.2	III 01	-21.6	800-225-2606
13	7.6	6.5	11.5	8.8	124334	Average	12	1	23	25	General Electric (4)	Low	IV 98	18.6	III 01	-13.7	800-225-2606
1	4.3	2.8	9.2	7.8	343325	Low	4	-5	NA	26	Nintendo (4)	Low	IV 98	15.5	III 98	-18.4	800-637-3863
1	10.8	8.4	10.7	8.5	443311	Very High	1	-9	18	78	Heller Financial (10)	Very Low	IV 98	7.3	III 98	-6.0	800-343-8959
8	25.0	22.9	NA	NA	123111	Average	0	10	29	28	Waste Management (4)	Low	II 99	25.0	III 98	-17.5	800-446-6662
9	5.5	3.5	8.5	6.1	345222	Average	1	12	26	18	SPX (2)	Low	IV 98	10.8	III 98	-11.7	800-637-3863
9	9.4	7.0	12.3	10.3	234322	Low	3	24	26	27	Citigroup (4)	Low	II 97	14.2	III 01	-14.3	800-637-3863
1	11.7	10.1	NA	NA	111300	High	6	-12	35	38	Lowe's Companies (5)	Average	IV 98	27.1	I 01	-15.1	800-637-3863
7	8.5	5.8	10.6	8.1	433321	Average	8	1	24	9	Security Capital Group (1)	Very Low	II 99	12.2	III 98	-13.2	800-637-3863
10	NA	NA	NA	NA	12435	High	4	-27	31	38	Lincoln National (5)	High	IV 99	35.8	I 01	-17.8	800-637-3863
5	7.5	6.1	NA	NA	324344	Low	1	2	21	50	Lattice Semiconductor (9)	Low	IV 99	19.3	III 01	-16.9	800-637-3863
1	17.8	15.0	16.3	13.7	123111	Average	9	16	23	18	Tech Data (3)	Average	IV 01	28.1	III 98	-26.0	800-637-3863
10	11.0	9.0	15.1	12.4	313333	High	7	-38	22	19	Tyco International (3)	Average	IV 99	28.7	III 01	-27.8	800-225-2606
6	4.5	4.0	NA	NA	333333	Low	2	6	NA	22	Oracle (12)	High	IV 99	35.9	III 01	-31.5	800-225-2606
8	7.2	4.1	10.0	7.7	313333	High	4	-31	27	22	Tyco International (3)	High	IV 99	30.2	III 01	-24.0	800-225-2606
13	15.7	13.5	NA	NA	123333	Average	2	-24	14	50	Verisign (11)	High	IV 99	39.9	III 01	-33.0	800-225-2606
1	NA	NA	NA	NA	3023	Low	7	-5	27	22	Caremark Rx (5)	Low	IV 99	55.2	III 01	-23.9	800-225-2606
19	8.5	5.2	12.3	10.4	233334	High	2	-11	22	25	Exxon Mobil (4)	Average	IV 98	22.0	III 01	-19.6	800-225-2606
8	16.0	14.8	NA	NA	113333	Average	4	-32	29	22	Tyco International (3)	High	IV 99	29.3	III 01	-25.4	800-225-2606
18	10.3	7.6	11.4	8.7	333312	High	4	5	17	14	New Center Asset Trust (2)	Very Low	II 97	9.3	III 01	-5.4	800-225-2606
19	5.4	5.3	NA	NA	123333	High	2	-34	15	27	U.S. Treas. Notes (4)	Low	IV 99	21.8	III 01	-17.3	800-225-2606
7	14.9	13.5	NA	NA	123333	Average	5	-1	19	22	St. Paul (3)	Low	II 97	13.7	III 01	-11.1	800-225-2606
19	NA	NA	NA	NA	1043	Average	0	-13	22	26	General Electric (4)	High	IV 98	22.9	III 01	-16.0	800-521-5411
1	6.8	4.1	10.3	8.1	234223	Very Low	0	5	18	39	Exxon Mobil (7)	Average	IV 98	16.6	III 01	-14.3	800-521-5411
NA	NA	NA	NA	NA	2	Average	1	28	19	29	Exxon Mobil (4)	High	IV 01	8.0	III 01	-10.8	800-445-1854
NA	NA	NA	NA	NA	2	Average	1	21	20	27	General Electric (4)	High	IV 01	10.8	III 01	-15.4	800-445-1854
NA	NA	NA	NA	NA	2	Average	5	17	17	16	AmerisourceBergen (2)	High	IV 01	16.4	III 01	-15.4	800-445-1854
NA	NA	NA	NA	NA	33	Very High	0	-39	29	20	Microsoft (4)	High	IV 99	41.7	I 01	-22.3	800-869-6397
13	10.5	7.6	11.5	9.1	113333	Very High	0	-36	28	28	Microsoft (5)	Average	IV 99	34.9	I 01	-20.3	800-869-6397
15	NA	NA	NA	NA	355	Low	0	-41	50	30	Microsoft (3)	High	IV 98	19.5	I 01	-17.3	800-869-6397
14	7.0	5.5	10.2	9.0	225223	Very Low	0	56	25	23	Fannie Mae (2)	Low	II 97	15.7	III 01	-13.3	800-869-6397
15	6.6	4.4	12.5	10.6	423334	Average	0	-4	30	35	GlaxoSmithKline (6)	Low	IV 99	24.3	III 98	-15.8	800-869-6397
19	4.8	2.8	NA	NA	434332	Low	0	-3	27	11	Computer Associates Intl. (1)	Low	IV 98	16.6	III 98	-12.6	800-869-6397
15	10.5	11.5	NA	NA	111125	Low	0	0	17	30	Verizon Communications (4)	Low	I 98	19.7	III 01	-12.2	800-869-6397

an Opport./B. (ag) Formerly Morgan Stanley Dean Witter Cmp. Eg: Best Idea/B. (ah) Formerly Morgan Stanley Dean Witter Dividend Gr. Sec./B. (ai) Formerly Morgan Stanley Dean Witter Gr./B. (aj) Formerly Morgan Stanley Dean Witter Gbl. Div. Gr. Sec./B. (ak) Formerly Morgan Stanley Dean Witter Gbl. Utilities/B.

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	SIZE ASSETS \$ MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	2001 RETURN PRE- TAX	AFTER TAX
MS GROWTH B (al)	C	Large-cap Growth	C	784.6	-31	0.00**	1.59†	-16.0	-16.
MS HEALTH SCIENCES B (am)	B+	Health	C	673.8	1	0.00**	1.57†	-8.5	-8.
MS INFORMATION B (an)	C-	Technology	C	1079.2	-59	0.00**	1.84†	-44.7	-44.
MS INSTL. MID CAP GROWTH INSTL. (ao) 1	B	Mid-cap Growth	B+	1213.6	-27	No load	0.61	-29.6	-29.
MS INSTL. MID CAP VALUE INSTL. (ap)	A	Mid-cap Blend	B+	1232.7	-2	No load	0.86	-3.3	-3.
MS INSTL. SMALL CAP VALUE INSTL. (aq) 1	C	Small-cap Blend	C	1133.7	-2	No load	0.85	-6.8	-6.
MS INSTL. VALUE ADV. (ar)	C	Large-cap Value	C-	835.3	73	No load	0.87†	3	3.
MS MID CAP EQUITY TR. B (as)	D	Mid-cap Growth	D	705.6	-50	0.00**	1.58†	-39.4	-39.
MS S&P 500 INDEX B (at)	B	Large-cap Blend	C	1532.8	-14	0.00**	1.50†	-13.2	-13.
MS STRATEGIST B (au) 1	B	Domestic Hybrid	C	1660.8	-18	0.00**	1.63†	-11.1	-11.
MS UTILITIES B (av) 1	B	Utilities	C	1764.2	-31	0.00**	1.63†	-21.8	-24.
MS VALUE ADDED MARKET B (aw)	B+	Large-cap Value	B	1019.4	-5	0.00**	1.59†	-3.0	-3.
MUNDER NETNET B	B+	Technology	B	635.9	-63	0.00**	2.61†	-48.6	-48.
MUTUAL BEACON Z 1	A	Mid-cap Value	B+	3046.7	3	No load	0.81	6.1	4.
MUTUAL DISCOVERY Z	A	World	A	1909.4	-4	No load	1.05	1.3	0.
MUTUAL QUALIFIED Z 1	B+	Large-cap Value	B+	2956.9	5	No load	0.80	8.2	5.
MUTUAL SHARES Z 1	B+	Mid-cap Value	B	5371.3	4	No load	0.78	5.3	4.
NASDAQ 100 INDEX TRACKING STOCK	B+	Large-cap Growth	B	22628.1	13	No load	0.18	-33.4	-33.
NATIONS MARSICO FOCUSED EQ INV. B	C	Large-cap Growth	B+	662.6	-26	0.00**	2.09†	-19.7	-19.
NEUBERGER BERMAN FOCUS INV. (ax) 1	C	Mid-cap Growth	B+	1565.1	1	No load	0.83	-6.7	-7.
NEUBERGER BERMAN GENESIS INV. (ay)	A	Small-cap Value	B	989.5	31	No load	1.11	12.1	11.
NEUBERGER BERMAN GUARDIAN INV. (az)	C-	Large-cap Value	F	1949.3	-14	No load	0.84	-1.8	-2.
NEUBERGER BERMAN PARTNERS INV. (ba)	C	Large-cap Value	C-	1655.2	-14	No load	0.84	-3.0	-3.
NEW ECONOMY A 1	C	World	B	8086.4	-22	5.75**	0.81†	-17.3	-17.
NEW PERSPECTIVE A 1	B	World	B+	27393.8	-11	5.75**	0.78†	-8.3	-8.
NEW WORLD A	C	Diversified Emerging Markets	C-	1117.9	-8	5.75**	1.35†	-4.0	-4.
NICHOLAS 1	C	Large-cap Blend	C-	3087.5	-24	No load	0.72	-11.0	-11.
NORTHERN GROWTH EQUITY	B	Large-cap Growth	B	873.7	-24	No load	1.00	-16.7	-16.
NORTHERN TECHNOLOGY	C-	Technology	B	637.1	-56	No load	1.25	-34.5	-34.
NUVEEN LARGE CAP VALUE A (bb)	B	Large-cap Value	B	662.1	-2	5.75**	1.32†	-2.3	-2.
OLSTEIN FINANCIAL ALERT C	A	All-cap	B+	717.3	65	0.00**	2.18†	17.2	15.
ONE GROUP LARGE CAP VALUE I	C	Large-cap Value	C	1286.0	-16	No load	0.96	-13.0	-13.
ONE GROUP MID CAP GROWTH I	B+	Mid-cap Growth	B+	1358.9	-5	No load	0.96	-10.7	-10.
ONE GROUP MID CAP VALUE I	B+	Mid-cap Value	B	1145.8	11	No load	0.96	5.0	3.
OPPENHEIMER CAPITAL APPRECIATION A 1	B	Large-cap Growth	B+	3240.0	5	5.75**	1.03†	-12.7	-13.
OPPENHEIMER CAPITAL INCOME A	B	Domestic Hybrid	C	2335.6	4	5.75**	0.91†	-0.2	-1.
OPPENHEIMER DISCOVERY A	D	Small-cap Growth	C-	825.3	-17	5.75**	1.25†	-11.6	-11.
OPPENHEIMER GLOBAL A	B+	World	A	5643.7	-2	5.75**	1.12†	-11.8	-11.
OPPENHEIMER GLOBAL GROWTH & INCOME A 1	B+	World	B+	1266.9	-14	5.75**	1.22†	-16.3	-16.
OPPENHEIMER GROWTH A	C-	Large-cap Growth	C-	1547.5	-31	5.75**	1.06†	-24.5	-24.
OPPENHEIMER MAIN STREET GROWTH & INC. A 1	C	Large-cap Blend	C-	7277.5	-6	5.75**	0.85†	-10.5	-10.
OPPENHEIMER MULTIPLE STRATEGIES A 1	B	Domestic Hybrid	C	600.0	0	5.75**	1.01†	1.7	0.
OPPENHEIMER QUEST BAL. VALUE B	A	Domestic Hybrid	A	2003.8	117	0.00**	2.06†	2.0	1.
OPPENHEIMER QUEST OPP. VALUE A 1	B	Large-cap Value	C	1324.2	2	5.75**	1.53†	-4.6	-4.
OPPENHEIMER QUEST VALUE A	C	Large-cap Value	C-	802.5	7	5.75**	1.56†	-7.9	-8.
OPPENHEIMER TOTAL RETURN A	C	Large-cap Blend	C	2827.8	-14	5.75**	0.87†	-10.4	-10.
PAX WORLD BALANCED	A	Domestic Hybrid	A	1162.0	-2	No load	0.90†	-9.1	-9.
PBHG GROWTH 1	F	Mid-cap Growth	F	2504.0	-37	No load	1.25	-34.5	-34.
PBHG TECHNOLOGY & COMMUNICATIONS 1	F	Technology	D	693.1	-58	No load	1.25	-52.4	-52.
PHOENIX-ENGEMANN CAPITAL GROWTH A	D	Large-cap Growth	D	1320.7	-43	5.75	1.06†	-35.2	-35.
PHOENIX-OAKHURST BALANCED A	E	Domestic Hybrid	C	1242.1	-9	5.75	1.00†	1.9	1.
PILGRIM INTERNATIONAL VALUE A	E	Foreign	A	1307.7	30	5.75**	1.64†	-13.3	-13.
PIMCO GROWTH C	C-	Large-cap Growth	C-	1223.5	-38	0.00**	1.90†	-29.6	-29.
PIMCO INNOVATION C	D	Technology	C	734.8	-55	0.00**	2.04†	-45.5	-45.
PIMCO RENAISSANCE C	A	Mid-cap Value	A	854.9	135	0.00**	2.00†	18.5	17.
PIMCO TARGET C	C	Mid-cap Growth	B	927.8	-33	0.00**	1.95†	-29.2	-29.
PIONEER A 1	B+	Large-cap Blend	B+	6089.1	-7	5.75**	1.11†	-11.0	-11.
PIONEER GROWTH SHARES A	C	Large-cap Growth	C	864.6	-30	5.75**	1.22†	-19.2	-19.
PIONEER MID CAP GROWTH A (hc)	D	Mid-cap Growth	D	676.8	-14	5.75**	0.85†	-11.4	-11.
PIONEER MID CAP VALUE A	B	Mid-cap Value	C-	875.0	8	5.75**	1.11†	5.5	4.
PIONEER VALUE A (bd)	C	Mid-cap Value	D	4188.8	-4	5.75**	0.94†	-3.1	-3.
T. ROWE PRICE BALANCED 1	B+	Domestic Hybrid	B	1788.7	-13	No load	0.79	-4.0	-5.
T. ROWE PRICE BLUE CHIP GROWTH	B	Large-cap Growth	B	6142.5	-14	No load	0.91	-14.4	-14.
T. ROWE PRICE CAPITAL APPRECIATION 1	A	Domestic Hybrid	A	1360.5	60	No load	0.87	10.3	8.
T. ROWE PRICE DIVIDEND GROWTH	B	Large-cap Blend	B+	682.7	-6	No load	0.81	-3.6	-4.
T. ROWE PRICE EQUITY IDX 500 1	B	Large-cap Blend	B	3423.8	-17	0.00*	0.40	-12.2	-12.
T. ROWE PRICE EQUITY INCOME	B+	Large-cap Value	B	9988.7	-3	No load	0.60	1.6	0.
T. ROWE PRICE GROWTH AND INCOME 1	E	Large-cap Value	C	2390.7	-23	No load	0.77	-2.2	-3.
T. ROWE PRICE GROWTH STOCK	B+	Large-cap Growth	B+	4615.3	-15	No load	0.73	-9.8	-10.
T. ROWE PRICE HEALTH SCIENCES	A	Health	C	935.8	8	No load	0.95	-6.0	-6.

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.

(al) Formerly Morgan Stanley Dean Witter Growth/B. (am) Formerly Morgan Stanley Dean Witter Health Sciences/B. (an) Formerly Morgan Stanley Dean Witter Information/B. (ao) Formerly MAS Fds:Mid Cap Growth Portfolio/Instl. (ap) Formerly MAS Fds:Mid Cap Value Portfolio/Instl. (ar) Formerly MAS Fds:Value (as) Formerly Morgan Stanley Dean Witter Mid Cap Eqty Tr/B. (at) Formerly Morgan Stanley Dean Witter S&P 500 Index/B. (au) Formerly Morgan Stanley Dean Witter Strategi

Equity Funds

ANNUAL TOTAL RETURNS (%)				HISTORY		PORTFOLIO DATA							RISK				TELEPHONE	
5 YEARS		10 YEARS		RESULTS VS.		TURNOVER	CASH %	UNTAXED GAINS %	P/E RATIO	TOP 10 STKS. %	LARGEST HOLDING COMPANY (% ASSETS)	LEVEL	BEST		WORST			
PRETAX	AFTERTAX	PRETAX	AFTERTAX	ALL FUNDS	QTR								% RET	QTR	% RET			
8.8	5.9	NA	NA	32244	Average	0	0	26	44	Tyco International (7)	Average	IX 98	25.1	I 01	-18.5	800-869-6397		
15.4	13.0	NA	NA	52418	High	0	22	36	33	Pfizer (5)	Average	II 00	23.2	I 01	-21.5	800-869-6397		
12.6	10.1	NA	NA	41155	High	0	-153	31	22	Intel (3)	Very High	IX 98	61.0	III 01	-36.8	800-869-6397		
14.9	11.9	14.0	10.7	11135	Average	5	-14	22	20	Polycom (3)	High	IX 99	39.2	III 01	-27.6	800-354-8185		
16.0	13.7	NA	NA	13312	High	8	-7	23	17	Valassis Communications (3)	Average	IX 99	22.5	III 01	-20.6	800-354-8185		
9.4	7.1	14.6	11.8	15322	High	10	17	20	14	NBTY (2)	Average	III 97	18.3	III 01	-19.5	800-354-8185		
8.4	6.1	NA	NA	35511	Low	1	12	22	29	Healthsouth (5)	Average	IX 00	15.7	III 98	-19.1	800-354-8185		
9.6	9.5	NA	NA	41155	Very Low	NA	-67	45	NA		Very High	IX 99	82.2	III 01	-40.4	800-869-6397		
NA	NA	NA	NA	1343	Very Low	NA	-4	32	NA			IX 98	21.1	III 01	-15.0	800-869-6397		
8.0	6.1	9.1	7.1	43323	High	0	2	21	18	Microsoft (2)	Low	IX 99	12.4	I 01	-11.3	800-869-6397		
7.0	4.6	7.7	5.7	22424	Very Low	0	29	17	23	Verizon Communications (3)	Low	IX 97	13.2	III 01	-11.4	800-869-6397		
10.7	8.8	12.3	11.1	23422	Very Low	0	46	37	4	Johnson & Johnson (1)	Low	IX 98	16.5	III 98	-14.1	800-869-6397		
NA	NA	NA	NA	155	Low	5	-234	34	51	AOL Time Warner (8)		IX 99	79.4	III 01	-47.7	800-468-6337		
12.3	9.3	15.8	13.1	34411	Average	13	17	22	21	Telephone & Data Systems (3)	Very Low	IX 98	12.6	III 98	-17.5	800-342-5236		
11.8	9.2	NA	NA	35311	Average	23	11	NA	17	Finova Capital (3)	Very Low	IX 99	14.2	III 98	-19.4	800-342-5236		
12.0	9.2	15.7	12.8	24411	Average	NA	22	NA	NA		Very Low	II 99	13.4	III 98	-17.7	800-342-5236		
12.1	9.4	15.5	12.5	24411	Average	15	20	23	22	Federated Department Stores (3)	Very Low	IX 98	13.3	III 98	-17.0	800-342-5236		
NA	NA	NA	NA	55	Low	0	NA	41	39	Microsoft (11)		IX 99	53.9	III 01	-36.6	800-537-3929		
NA	NA	NA	NA	1254	Very Low	9	-22	25	55	General Electric (7)		IX 99	32.9	I 01	-18.0	800-321-7854		
13.2	10.7	15.4	12.9	33312	Low	3	30	20	58	Citigroup (9)	High	IX 98	34.5	III 01	-29.2	800-366-6264		
14.2	13.5	15.3	14.3	15511	Low	2	22	19	22	Aptargroup (3)	Low	III 97	20.1	III 98	-16.4	800-366-6264		
4.8	1.4	10.4	7.9	44432	High	7	7	20	33	S&P 500 Futures (4)	Average	IX 98	23.1	III 98	-26.2	800-366-6264		
7.6	5.0	12.7	9.8	24422	Average	2	6	21	25	Citigroup (3)	Average	IX 98	16.4	III 01	-15.9	800-366-6264		
10.8	8.8	12.7	10.7	21244	Average	9	-15	31	28	Berkshire Hathaway A (5)	Average	IX 99	27.2	III 01	-25.2	800-421-0180		
12.0	10.1	13.0	11.2	41232	Low	9	12	29	18	Astrazeneca (3)	Low	IX 99	22.2	III 01	-15.0	800-421-0180		
NA	NA	NA	NA	52	Low	11	-25	20	20	Petrolas (2)		IX 99	25.2	III 01	-18.3	800-421-0180		
6.7	4.4	10.0	7.8	15532	Average	1	30	25	27	Mercury General Fund (4)	Average	IX 98	19.3	III 01	-16.0	800-227-5987		
10.7	8.7	NA	NA	11334	Average	0	9	24	26	General Electric (3)	Average	IX 98	24.8	III 01	-15.8	800-595-9111		
15.1	12.0	NA	NA	41155	High	0	-157	119	48	Electronic Arts (7)	Very High	IX 99	55.2	IX 00	-43.8	800-595-9111		
11.1	9.3	NA	NA	24422	High	NA	11	NA	NA		Low	IX 98	15.7	III 98	-16.6	800-257-8787		
22.6	18.7	NA	NA	13211	Average	5	6	20	20	Triquint Semiconductor (2)	Average	IX 99	27.7	III 01	-22.1	800-799-2113		
11.2	6.7	9.9	7.9	23423	High	0	2	18	29	Exxon Mobil (6)	Average	IX 98	15.5	III 01	-16.5	800-480-4111		
10.9	14.2	14.8	12.0	21223	Average	1	-2	24	20	Genzyme (3)	High	IX 98	39.9	III 01	-21.0	800-480-4111		
14.0	11.0	13.6	10.9	14511	High	4	12	24	17	Telephone & Data Systems (2)	Low	IX 98	16.0	III 98	-13.6	800-480-4111		
13.9	12.0	14.3	12.1	22233	Low	13	-4	25	25	AOL Time Warner (5)	Average	IX 99	28.9	III 01	-19.9	800-525-7048		
9.4	8.8	11.1	8.7	24512	Average	4	16	17	22	Philip Morris (4)	Low	II 97	11.3	III 01	-11.4	800-525-7048		
4.8	3.3	9.2	7.8	45243	Average	17	-9	24	14	Webex Communications (2)	High	IX 99	59.4	III 01	-23.6	800-525-7048		
14.8	12.3	12.5	10.2	33123	Low	5	6	28	23	Cadence Design Systems (4)	Average	IX 99	36.4	III 01	-17.8	800-525-7048		
16.7	14.6	13.8	11.7	23134	Average	1	-19	22	38	National Semiconductor (7)	Average	IX 99	32.5	III 01	-25.0	800-525-7048		
5.2	3.5	9.9	7.7	43245	Average	0	-13	29	40	Kohls (5)	High	IX 99	30.2	IX 00	-25.6	800-525-7048		
8.9	7.4	15.0	13.1	22433	Average	5	3	23	20	General Electric (3)	Average	IX 98	22.1	III 01	-11.5	800-525-7048		
8.8	6.0	10.3	7.9	44421	Low	12	13	24	12	IBM (2)	Very Low	IX 98	11.2	III 01	-11.0	800-525-7048		
15.1	13.0	NA	NA	11421	High	11	-2	20	34	Freddie Mac (6)	Very Low	IX 98	21.3	III 99	-6.0	800-525-7048		
6.2	5.6	13.2	11.9	14403	Average	9	12	18	37	Freddie Mac (8)	Low	IX 98	12.6	III 98	-13.0	800-525-7048		
7.6	6.4	12.1	10.6	24512	Average	9	13	20	40	Freddie Mac (7)	Low	II 97	13.5	III 98	-13.6	800-525-7048		
9.1	7.2	11.7	9.5	22333	Average	10	15	23	32	Freddie Mac (5)	Average	IX 98	18.3	III 01	-13.9	800-525-7048		
11.9	9.9	9.0	7.9	23323	Low	10	10	21	25	Peoples Energy (2)	Very Low	IX 98	14.2	III 01	-7.6	800-767-1729		
-1.2	-1.9	11.9	10.7	54155	Average	10	-45	40	34	Laboratory Corp. of America (3)	Very High	IX 99	54.5	IX 00	-32.6	800-433-0051		
4.7	3.4	NA	NA	43155	High	7	27	58	45	Cisco (8)	Very High	IX 99	111.5	IX 00	-51.0	800-433-0051		
1.8	-0.4	6.1	3.6	11225	Average	7	-15	23	31	Pfizer (5)	High	IX 99	26.7	III 01	-29.5	800-814-1897		
9.5	5.8	8.8	6.2	34401	Average	6	11	20	19	General Electric (2)	Very Low	IX 98	13.5	III 01	-7.1	800-243-4361		
12.3	10.3	NA	NA	43301	Low	3	-10	19	27	Imperial Chemical (3)	Average	IX 99	24.5	III 98	-14.7	800-992-0180		
7.2	4.8	8.9	6.4	31245	Average	4	-5	24	37	American Intl. Group (4)	High	IX 99	38.2	I 01	-23.7	800-927-4648		
12.1	10.5	NA	NA	51156	High	15	-131	20	32	Micron Technology (4)	Very High	IX 99	79.9	III 01	-46.4	800-927-4648		
21.4	17.9	17.7	15.1	12411	High	5	8	11	40	Ace Limited (5)	Low	IX 01	21.0	III 98	-16.8	800-927-4648		
12.7	9.7	NA	NA	42125	Average	8	-3	23	35	Calpine (5)	High	IX 99	52.7	III 01	-27.2	800-927-4648		
13.0	11.7	13.7	11.8	11429	Low	NA	28	25	NA		Low	IX 98	22.5	III 01	-14.0	800-821-1239		
8.5	7.5	10.3	8.0	11406	Average	NA	-23	27	NA		Average	II 97	24.1	III 01	-18.6	800-821-1239		
5.1	2.5	8.6	6.1	54355	Low	NA	0	30	NA		High	IX 99	32.2	III 01	-23.0	800-821-1239		
9.4	7.3	14.7	12.5	33411	Average	NA	12	25	NA		Low	II 99	13.9	III 98	-21.4	800-821-1239		
5.4	3.8	9.9	7.5	35512	Very Low	NA	28	20	NA		Average	II 97	15.5	III 98	-22.3	800-821-1239		
8.3	7.1	9.9	8.2	33422	Very Low	1	20	20	13	U.S. Treas. Bonds 11/96 (3)	Very Low	IX 98	12.2	III 01	-6.9	800-638-5660		
10.5	10.1	NA	NA	21304	Average	2	8	23	29	Citigroup (4)	Average	IX 98	24.7	I 01	-17.2	800-638-5660		
12.1	9.2	12.8	10.2	44311	Low	0	12	13	42	Amerada Hess (5)	Very Low	II 99	10.5	III 01	-4.1	800-638-5660		
9.3	8.0	NA	NA	13522	Average	0	21	19	23	Citigroup (3)	Low	IX 98	13.1	III 01	-9.6	800-638-5660		
10.4	9.9	12.6	11.7	11343	Average	0	19	20	24	General Electric (4)	Average	IX 98	21.3	III 01	-14.7	800-638-5660		
10.9	8.5	14.0	11.6	24511	Low	5	18	17	21	Exxon Mobil (3)	Low	II 99	13.3	III 99	-8.5	800-638-5660		
8.5	6.5	12.4	10.4	34522	Average	4	28	20	23	Pfizer (4)	Low	II 97	12.9	III 01	-10.8	800-638-5660		
12.2	9.2	13.4	10.8	21323	Average	6	16	23	31	Citigroup (4)	Average	IX 98	23.1	I 01	-15.0	800-638-5660		
17.7	16.1	NA	NA	32412	Average	1	12	34	41	Pfizer (6)	Average	II 01	21.4	I 01	-25.4	800-638-5660		

anley Dean Witter Utilities/B. (aw) Formerly Morgan Stanley Dean Witter Value-Added Mkt/B. (ax) Formerly Neuberger Berman Focus Fund. (ay) Formerly Neuberger Berman
 (bz) Formerly Neuberger Berman Guardian Fund. (ba) Formerly Neuberger Berman Partners Fund. (bb) Formerly Nuveen Growth and Income Stock Fund/A. (bc) Formerly Pio-
 ind/A. (bd) Formerly Pioneer II/A.

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	RATING	SIZE		FEES		2001 RETN	
				ASSETS \$MIL.	% CHG. 2000-2001	SALES CHARGE (%)	EXPENSE RATIO (%)	PRE- TAX	AFT- TAX
T. ROWE PRICE INTL. EUROPEAN STOCK	C	Europe	B	843.8	-28	No load	1.02	-20.7	-2
T. ROWE PRICE INTL. NEW ASIA	F	Pacific/Asia ex-Japan	B	597.8	-26	No load	1.08	-10.0	-10
T. ROWE PRICE INTL. STOCK	C-	Foreign	C	6582.0	-33	No load	0.84	-22.0	-2
T. ROWE PRICE MEDIA & TELECOMMUNICATIONS		Communications		648.7	-20	No load	0.94	-6.9	-4
T. ROWE PRICE MID-CAP GROWTH	B+	Mid-cap Growth	B+	6354.0	8	No load	0.95	-1.0	-
T. ROWE PRICE NEW AMERICA GROWTH	C-	Large-cap Blend	F	1156.7	-23	No load	0.85	-11.9	-1
T. ROWE PRICE NEW ERA	C	Natural Resources	B+	1027.6	-5	No load	0.72	-4.4	-
T. ROWE PRICE NEW HORIZONS	C-	Small-cap Growth	C	5234.7	-10	No load	0.86	-2.8	-3
T. ROWE PRICE PERSONAL STRATEGY BALANCED	B+	Domestic Hybrid	B	651.4	4	No load	0.90	-2.5	-
T. ROWE PRICE SCIENCE & TECHNOLOGY	F	Technology	C-	5272.0	-41	No load	1.09	-41.2	-4
T. ROWE PRICE SMALL CAP STOCK	B+	Small-cap Blend	B+	2856.4	38	No load	0.82	5.8	1
T. ROWE PRICE SMALL CAP VALUE	B+	Small-cap Value	C	1870.5	47	0.00*	0.80	21.9	2
T. ROWE PRICE SPECTRUM GROWTH	C	All-cap	C	2308.7	-17	No load	0.83	-7.6	-8
T. ROWE PRICE VALUE	B+	Mid-cap Value	B	1277.9	41	No load	1.10	1.6	0
PRUDENTIAL EQUITY A	C	Large-cap Value	D	1563.2	-23	5.00	0.62†	-12.1	-13
PRUDENTIAL JENNISON GROWTH A	C	Large-cap Growth	C	1280.8	-28	5.00	0.81†	-18.6	-18
PRUDENTIAL STOCK INDEX I		Large-cap Blend		1209.7	-19	No load	0.30	-12.1	-12
PRUDENTIAL UTILITY A	B	Utilities	B	3109.0	-15	5.00	0.54†	-19.2	-20
PRUDENTIAL VALUE A	B	Mid-cap Value	C-	881.8	10	5.00	1.16†	-2.9	-
PUTNAM ASSET ALLOCATION BALANCED A	C	Domestic Hybrid	D	1320.5	0	5.75**	1.11†	-6.4	-7
PUTNAM ASSET ALLOCATION CONSERVATIVE A	B	Domestic Hybrid	C	802.6	55	5.75**	1.29†	-0.2	-2
PUTNAM ASSET ALLOCATION GROWTH A	C	Domestic Hybrid	D	734.0	-4	5.75**	1.25†	-10.0	-10
PUTNAM BALANCED RETIREMENT A	B+	Domestic Hybrid	B	808.7	28	5.75**	1.08†	3.3	2
PUTNAM CAPITAL APPRECIATION A	C-	All Cap	C-	762.0	-21	5.75**	1.00†	-15.4	-15
PUTNAM CLASSIC EQUITY A	C	Large-cap Value	D	1159.2	5	5.75**	0.94†	-6.8	-7
PUTNAM EQUITY INCOME A	B	Large-cap Value	C	1247.9	18	5.75**	0.96†	-1.6	-2
PUTNAM EUROPE GROWTH A	C	Europe	C	864.9	-29	5.75**	1.23†	-22.9	-23
PUTNAM FUND FOR GROWTH AND INCOME A	C	Large-cap Value	C-	18693.3	-4	5.75**	0.81†	-6.4	-7
PUTNAM GLOBAL EQUITY A	C	World	B	613.4	-7	5.75**	1.17†	-22.0	-22
PUTNAM GLOBAL GROWTH A	D	World	D	3108.6	-37	5.75**	1.07†	-29.8	-29
PUTNAM GROWTH OPPORTUNITIES A	C-	Large-cap Growth	D	1866.7	-31	5.75**	0.99†	-32.2	-32
PUTNAM HEALTH SCIENCES A	B	Health	C-	3375.4	-16	5.75**	0.96†	-19.8	-20
PUTNAM INTERNATIONAL GROWTH A	C	Foreign	A	6415.2	-5	5.75**	1.13†	-19.8	-19
PUTNAM INTERNATIONAL NEW OPPORTUNITIES A	D	Foreign	D	729.3	-38	5.75**	1.48†	-28.6	-28
PUTNAM INTERNATIONAL VOYAGER A	C	Foreign	A	782.4	-30	5.75**	1.47†	-27.3	-27
PUTNAM INVESTORS A	C-	Large-cap Growth	C-	5073.3	-29	5.75**	0.89†	-24.8	-24
PUTNAM NEW OPPORTUNITIES A	D	Large-cap Growth	D	10511.6	-30	5.75**	0.89†	-30.1	-30
PUTNAM NEW VALUE A	B	Large-cap Value	C	608.7	63	5.75**	1.11†	3.3	2
PUTNAM OTC EMERGING GROWTH A	F	Small-cap Growth	F	1817.6	-44	5.75**	1.04†	-46.1	-46
PUTNAM RESEARCH A	B	Large-cap Blend	C	1096.5	12	5.75**	1.05†	-18.9	-19
PUTNAM UTILITIES GROWTH AND INCOME A	C	Utilities	C-	828.7	-25	5.75**	1.01†	-22.5	-23
PUTNAM VISTA A	D	Mid-cap Growth	C-	4043.4	-30	5.75**	0.89†	-33.6	-34
PUTNAM VOYAGER A	C-	Large-cap Growth	C	15936.5	-25	5.75**	0.88†	-22.5	-23
PUTNAM VOYAGER II A	D	All-cap	F	995.7	-32	5.75**	0.99†	-30.5	-30
RAINIER CORE EQUITY	B	Large-cap Growth	B+	712.4	-18	No load	1.11†	-13.3	-13
RED OAK TECHNOLOGY SELECT		Technology		886.0	-52	No load	0.98	-56.0	-56
ROYCE LOW PRICED STOCK	A	Small-cap Value	A	852.1	819	0.00*	1.49†	25.1	25
ROYCE PREMIER	B+	Small-cap Value	C	748.8	23	0.00*	1.20	9.6	9
RS DIVERSIFIED GROWTH A	A	Small-cap Growth	A	713.6	43	No load	1.51†	1.9	1
RS EMERGING GROWTH A	C	Mid-cap Growth	B	2461.1	-35	No load	1.29†	-27.3	-27
F. RUSSELL DIVERSIFIED EQUITY S	C	Large-cap Blend	C-	1194.3	-13	No load	0.94	-14.8	-15
F. RUSSELL INSTL. EQUITY 1 I	C	Large-cap Blend	C-	882.6	-35	No load	0.69	-14.5	-14
F. RUSSELL INSTL. EQUITY 2 I	B	Small-cap Blend	B	825.3	-10	No load	0.89	-1.9	-2
F. RUSSELL INSTL. EQUITY Q I	B	Large-cap Blend	B+	1060.6	-15	No load	0.88	-10.3	-10
F. RUSSELL INSTL. INTERNATIONAL I	C-	Foreign	C	677.8	-36	No load	1.00	-21.8	-21
F. RUSSELL INTERNATIONAL SECURITIES S	C-	Foreign	C	840.6	-18	No load	1.29	-22.0	-22
F. RUSSELL QUANTITATIVE EQUITY S	B	Large-cap Blend	B	1289.6	-9	No load	0.92	-10.6	-10
F. RUSSELL REAL ESTATE SECURITIES S	B	Real Estate	B	636.1	-6	No load	1.16	7.6	5
F. RUSSELL SPECIAL GROWTH S	B	Small-cap Blend	B	853.0	-4	No load	1.31	-2.3	-2
RYDEX OTC INV.	C-	Large-cap Growth	C-	1001.7	-47	No load	1.16	-34.7	-34
SAFECO EQUITY	C	Large-cap Value	D	1088.7	-25	No load	0.89	-9.7	-9
SAFECO GROWTH OPPORTUNITIES	B	Small-cap Growth	B+	883.6	10	No load	1.05	22.2	22
SALOMON BROTHERS INVESTORS VALUE O	B+	Large-cap Value	B+	655.7	-3	No load	0.73	-4.2	-4
SCHWAB 1000 INVESTOR	B	Large-cap Blend	B	4116.5	-12	0.00*	0.46	-12.3	-12
SCHWAB CAPITAL S&P 500 SELECT		Large-cap Blend		3877.7	-4	0.00*	0.19	-12.0	-12
SCHWAB CAPITAL SMALL CAP INDEX INV.	C	Small-cap Growth	B	870.5	18	0.00*	0.49	-0.9	-1
SCHWAB INTERNATIONAL INDEX SELECT		Foreign		643.2	-6	0.00*	0.47	-22.7	-23
SCUDDER CAPITAL GROWTH AARP	C	Large-cap Growth	B	1438.9	-33	No load	0.88	-20.4	-20
SCUDDER DREMAN HI RETURN A (be)	B+	Large-cap Value	B	2104.1	27	5.75**	1.27	1.2	0
SCUDDER GLOBAL S	C	World	C	1005.0	-25	No load	1.33	-16.4	-17

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.
(be) Formerly Kemper Dremann High Return Fund/A.

Equity Funds

ANNUAL TOTAL RETURNS (%)				HISTORY	PORTFOLIO DATA						RISK		TELEPHONE	
5 YEARS PRETAX	5 YEARS AFTER TAX	10 YEARS PRETAX	10 YEARS AFTER TAX	RESULTS VS. ALL FUNDS	TURNOVER	CASH %	UNTAXED GAINS %	P/E RATIO	TOP 10 STKS. %	LARGEST HOLDING COMPANY (% ASSETS)	LEVEL	BEST QTR % RET	WORST QTR % RET	
5.6	3.8	9.6	8.4	423344	Low	7	8	15	31	GlaxoSmithKline (6)	Average	IV 99 20.5	I 01 -17.1	800-225-5132
-7.0	-7.2	2.8	2.1	551533	Average	0	-26	9	43	Hutchinson Whampoa (5)	Very High	IV 99 42.0	IV 97 -27.1	800-225-5132
0.7	-0.5	6.1	4.8	522444	Low	0	-3	14	25	GlaxoSmithKline (5)	Average	IV 99 24.7	I 01 -15.5	800-225-5132
NA	NA	NA	NA	11152	High	3	-39	47	39	Western Wireless (7)		IV 99 41.6	III 98 -18.6	800-638-5660
13.7	13.0	NA	NA	423322	Low	7	19	21	23	Concord Efs (2)	Average	IV 98 28.8	III 01 -17.7	800-638-5660
4.9	3.0	10.1	8.5	134433	Average	7	15	24	30	Waddell & Reed Finl A (3)	High	IV 98 27.7	III 01 -21.8	800-638-5660
8.9	4.6	10.0	7.7	453112	Low	4	30	15	29	Exxon Mobil (4)	Average	II 99 15.0	III 98 -12.4	800-638-5660
8.1	6.6	13.8	11.2	342332	Low	2	23	28	16	Bisys Group (2)	High	IV 01 30.2	III 01 -25.2	800-638-5660
8.3	6.8	NA	NA	434422	Average	5	3	18	13	U.S. Treas. Bonds 8/96 (3)	Very Low	IV 98 11.2	III 01 -7.1	800-638-5660
2.4	0.4	13.1	10.6	511102	Average	15	-94	37	51	Verisign (7)	Very High	IV 98 47.9	III 01 -40.3	800-638-5660
12.2	11.0	14.5	11.8	234411	Low	8	16	15	22	Harmon Intl. (2)	Average	IV 01 19.3	III 98 -19.4	800-638-5660
10.8	8.9	14.6	13.0	255111	Very Low	7	27	13	26	Brown & Brown (4)	Low	II 99 16.7	III 98 -20.2	800-638-5660
8.3	6.1	11.9	9.6	433322	Very Low	0	-7	19	100	T. Rowe Price Intl. Funds (23)	Average	IV 98 18.6	III 01 -15.4	800-638-5660
12.1	10.1	NA	NA	244111	Average	0	2	17	18	Honeywell Intl. (2)	Low	II 99 15.0	III 98 -13.4	800-638-5660
0.8	4.4	11.9	9.5	344423	Average	2	NA	NA	19	Microsoft (3)	Average	II 99 15.1	III 01 -15.9	800-225-1852
11.5	10.0	NA	NA	111254	Average	3	NA	NA	33	Citigroup (4)	High	IV 98 30.1	III 01 -20.0	800-225-1852
NA	NA	NA	NA	1345	Very Low	5	NA	NA	24	General Electric (4)		IV 98 21.3	III 01 -14.8	800-225-1852
10.2	7.2	11.3	8.7	245114	Low	3	NA	NA	29	El Paso Corporation (4)	Low	III 00 19.0	III 01 -14.6	800-225-1852
10.7	8.1	12.8	10.1	154112	Average	4	NA	NA	16	Citigroup (2)	Average	II 97 17.2	III 98 -18.4	800-225-1852
6.9	4.9	NA	NA	433322	High	0	-11	26	NA	General Electric	Low	IV 98 15.0	III 98 -11.3	800-225-1581
5.9	3.7	NA	NA	444432	High	0	-12	NA	NA	General Electric	Very Low	IV 98 8.6	III 98 -6.0	800-225-1581
6.5	4.3	NA	NA	433433	High	0	-23	25	NA	General Electric	Low	IV 98 19.3	III 98 -13.9	800-225-1581
11.2	5.8	10.2	7.8	445211	High	9	3	22	NA	Exxon Mobil	Very Low	II 97 8.6	III 99 -6.1	800-225-1581
5.7	4.5	NA	NA	243334	Very High	1	-4	30	NA	Microsoft	Average	IV 99 23.9	III 01 -19.1	800-225-1581
0.6	4.9	NA	NA	215222	Average	4	-2	25	NA	Exxon Mobil	Low	IV 98 17.0	III 01 -12.6	800-225-1581
9.8	8.1	12.5	10.9	235112	Average	4	5	22	NA	Exxon Mobil	Low	IV 98 13.9	III 99 -10.2	800-225-1581
6.2	5.0	10.7	9.6	323334	Average	0	-10	23	31	Shell Trans. & Trading (4)	Average	IV 99 21.8	III 98 -18.3	800-225-1581
7.9	5.8	12.0	9.7	335222	Average	2	9	24	NA	Citigroup	Low	IV 98 16.7	III 01 -11.0	800-225-1581
10.3	7.7	NA	NA	321444	Very High	1	-21	26	NA	Total Fina ELF	Average	IV 99 35.3	III 01 -16.8	800-225-1581
3.5	1.1	7.6	5.6	411555	High	2	-41	30	NA	AOL Time Warner	High	IV 99 47.6	I 01 -25.1	800-225-1581
7.6	7.6	NA	NA	212555	Average	0	-57	36	40	General Electric (7)	High	IV 99 36.1	I 01 -27.5	800-225-1581
12.5	11.1	11.9	10.6	115114	Low	2	22	35	NA	Pfizer	Average	II 97 20.3	I 01 -22.5	800-225-1581
10.4	8.3	11.7	10.9	421444	Average	3	-13	24	NA	Munich Re	Average	IV 99 35.7	III 98 -19.1	800-225-1581
1.4	-0.1	NA	NA	531155	Very High	2	-57	29	NA	GlaxoSmithKline	High	IV 99 58.9	I 01 -22.4	800-225-1581
12.8	12.1	NA	NA	411445	Very High	1	-49	22	NA	Van Der Moolen Holdings	High	IV 99 50.3	III 01 -24.4	800-225-1581
7.8	7.0	11.6	9.2	111255	Average	0	-18	31	32	Citigroup (4)	High	IV 98 25.3	I 01 -20.3	800-225-1581
0.0	4.8	14.1	13.3	321555	Average	4	-14	40	25	General Electric (4)	High	IV 99 50.0	III 01 -29.3	800-225-1581
5.6	8.0	NA	NA	345111	Average	3	4	22	NA	Citigroup	Low	IV 98 16.4	III 01 -13.9	800-225-1581
-6.1	-7.3	6.1	4.1	531155	Average	0	-159	40	21	Marvell Technology Group (3)	Very High	IV 98 81.3	I 01 -43.2	800-225-1581
11.7	10.1	NA	NA	113334	High	2	-22	28	NA	Coca Cola	Average	IV 98 23.8	III 01 -20.2	800-225-1581
5.8	3.3	6.5	6.2	335114	Low	1	-1	20	NA	SBC Communications	Low	IV 97 12.2	III 01 -11.1	800-225-1581
7.5	5.2	12.6	10.0	321335	Average	0	-49	32	21	Convergys (3)	High	IV 98 42.1	III 01 -32.2	800-225-1581
9.5	7.8	12.5	10.8	221444	High	0	-3	31	27	General Electric (5)	High	IV 99 40.2	I 01 -19.1	800-225-1581
5.2	4.6	NA	NA	321555	Average	1	-44	40	16	Bed Bath and Beyond	Very High	IV 99 54.6	III 01 -32.2	800-225-1581
11.2	9.5	NA	NA	123333	Average	0	8	22	20	Microsoft (4)	Average	IV 98 25.1	III 01 -15.2	800-248-6314
NA	NA	NA	NA	145	Low	0	-225	NA	64	Semtech (11)		IV 99 68.7	III 01 -49.2	888-462-5386
13.7	18.2	NA	NA	342111	Average	0	10	12	17	Transaction Systems Architects (2)	Average	IV 01 27.7	III 98 -21.5	800-348-1414
12.6	11.2	13.6	12.2	444411	Low	0	25	12	32	White Mountains Insurance Group (4)	Low	II 99 21.0	III 01 -14.8	800-348-1414
22.9	20.8	NA	NA	231511	Very High	4	-20	17	21	Regeneration Technologies (3)	High	IV 99 62.9	III 01 -29.4	800-766-3863
18.5	16.4	14.4	12.3	411155	High	13	-43	29	30	Cytec (4)	Very High	IV 99 75.2	III 01 -31.3	800-766-3863
5.1	5.9	11.4	8.6	133444	High	8	1	20	26	General Electric (3)	Average	IV 98 22.5	III 01 -16.2	800-426-7969
8.5	5.9	12.0	9.0	123444	High	7	13	22	25	General Electric (3)	Average	IV 98 22.5	III 01 -16.0	800-426-7969
11.3	9.0	12.8	10.0	243322	High	5	15	35	11	Suiza Foods (1)	Average	IV 99 20.9	III 98 -21.7	800-426-7969
11.2	8.4	13.9	10.9	123333	Average	3	12	41	26	General Electric (4)	Average	IV 98 23.0	III 01 -15.1	800-426-7969
0.6	-0.6	5.2	3.6	533444	High	1	-15	NA	17	GlaxoSmithKline PLC (1)	Average	IV 99 18.8	III 98 -15.8	800-426-7969
0.4	-0.6	4.7	3.4	533444	High	1	-15	NA	16	GlaxoSmithKline PLC (1)	Average	IV 99 20.3	III 98 -15.9	800-426-7969
10.7	8.5	13.2	10.5	133333	Average	4	9	19	26	General Electric (4)	Average	IV 98 22.6	III 01 -15.2	800-426-7969
7.0	4.8	12.1	9.7	335111	Average	3	16	17	44	Equity Office Properties (8)	Low	III 97 10.4	III 98 -10.3	800-426-7969
10.0	8.7	12.3	9.8	343322	High	7	14	15	12	BISYS Group (1)	Average	IV 01 19.7	III 98 -22.0	800-426-7969
13.1	13.0	NA	NA	311155	Very High	4	24	30	42	Microsoft (11)	Very High	IV 99 53.0	III 01 -36.8	800-820-0888
8.4	5.4	12.9	10.9	324433	Low	2	31	22	36	General Electric (4)	Average	IV 98 18.7	III 01 -11.5	800-528-6501
13.4	12.5	13.0	10.6	145331	Low	0	18	80	38	United Stationers (5)	High	II 01 34.5	III 98 -25.4	800-528-6501
12.5	9.6	14.6	11.0	234322	Average	5	14	21	23	U.S. Treas. Notes (4)	Low	IV 98 17.4	III 01 -12.8	800-446-1013
10.3	10.1	12.4	12.0	113333	Low	0	30	28	22	General Electric (4)	Average	IV 98 21.9	III 01 -15.4	800-265-5623
NA	NA	NA	NA	1345	Low	0	2	28	24	General Electric (4)		IV 98 21.2	III 01 -14.7	800-435-4000
9.1	0.1	NA	NA	533322	Low	0	1	24	5	Rite Aid (1)	Average	IV 01 19.8	III 98 -20.9	800-435-4000
NA	NA	NA	NA	3354	Very Low	0	-21	23	23	BP Amoco (4)		IV 99 20.0	III 98 -14.9	800-265-5623
10.1	8.2	10.8	9.0	123334	Low	2	-11	35	34	Microsoft (5)	Average	IV 98 25.8	III 01 -20.6	800-621-1048
12.9	11.3	16.2	14.9	135111	Very Low	8	8	20	49	Philip Morris (11)	Low	III 00 22.8	III 99 -12.7	800-621-1048
5.7	3.1	9.0	7.2	402334	Low	4	-7	17	20	Bundesrepublik Deutschland 5 X % (3)	Low	IV 99 15.2	III 01 -13.3	800-621-1048

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	SIZE ASSETS \$MIL	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	2001 RETN PRE- TAX	AFT- TAX
SCUDDER GREATER EUROPE GROWTH	C	Europe	B	715.1	-44	No load	1.42	-25.7	-25
SCUDDER GROWTH & INCOME AARP		Large-cap Value		3855.7	-26	No load	0.76	-12.1	-12
SCUDDER GROWTH A (bf)	D	Large-cap Growth	D	1373.2	-32	5.75**	1.02	-23.0	-23
SCUDDER INTERNATIONAL S	C-	Foreign	B	2789.6	-35	No load	1.07	-26.8	-27
SCUDDER LARGE COMPANY GROWTH S	C-	Large-cap Growth	C	795.8	-35	No load	1.07	-22.7	-22
SCUDDER LARGE COMPANY VALUE	B	Large-cap Value	C	2167.7	-5	No load	0.89	-12.5	-13
SCUDDER TECHNOLOGY A (bg)	D	Technology	C	1695.9	-40	5.75**	0.99	-34.4	-34
SCUDDER TOTAL RETURN A (bh)	C	Domestic Hybrid	C-	2406.8	-11	5.75**	1.01	-6.8	-7
SECURITY EQUITY A 1	C	Large-cap Growth	C	612.0	-20	5.75**	1.02	-11.8	-11
SEI EMERGING MARKETS EQUITY	F	Diversified Emerging Markets	C-	1166.6	2	No load	1.95	-2.5	-2
SEI INTERNATIONAL EQUITY A 1	C-	Foreign	C	2518.8	-11	No load	1.26	-22.5	-22
SELECT SECTOR SPDR FINANCIAL		Financial		891.7	153	No load	0.44†	-9.1	-9
SELECT SECTOR SPDR TECHNOLOGY		Technology		1281.2	50	No load	0.42†	-23.0	-23
SELECTED AMERICAN	B+	Large-cap Value	B+	5456.9	14	No load	0.92†	-11.2	-11
SELIGMAN COMMUNICATIONS & INFORMATION A 1 C-	C-	Communications	C	3446.3	-9	4.75**	1.31†	5.6	3
SELIGMAN GROWTH A	C-	Large-cap Growth	C-	586.7	-28	4.75**	1.14†	-19.3	-20
SENTINEL COMMON STOCK A	C	Large-cap Value	C-	1130.4	-14	5.00**	1.03†	-10.0	-12
SENTINEL WORLD A	C-	Foreign	B	999.6	937	5.00**	1.23†	-16.2	-16
SEQUOIA 1	A	Large-cap Value	A	4058.0	3	No load	1.00	10.8	9
SMALLCAP WORLD A 1	D	World	C-	8421.6	-24	5.75**	1.09†	-17.4	-17
SMITH BARNEY AGGRESSIVE GROWTH A 1	A	Large-cap Growth	A	2106.0	36	5.00**	1.99†	-5.0	-5
SMITH BARNEY APPRECIATION A 1	B+	Large-cap Blend	B+	3088.4	-1	5.00**	0.87†	-3.4	-4
SMITH BARNEY BALANCED A	C	Domestic Hybrid	D	670.2	-8	5.00**	1.02†	-12.1	-13
SMITH BARNEY FUNDAMENTAL VALUE B	B+	Large-cap Value	B+	1567.9	22	0.00**	1.83†	-7.0	-7
SMITH BARNEY GROWTH AND INCOME 1	C	Domestic Hybrid	F	722.5	-22	8.50	0.78	-11.5	-11
SMITH BARNEY LARGE CAP CORE 1	B	Large-cap Growth	B	3382.7	-21	8.50	0.71	-14.8	-15
SMITH BARNEY LARGE CAP GROWTH B		Large-cap Growth		1451.6	-18	0.00**	1.86†	-13.5	-13
SMITH BARNEY PREMIUM TOTAL RETURN A	B	Domestic Hybrid	C	888.2	17	5.00**	1.09†	-3.6	-5
SOUND SHORE 1	B+	All Cap	B	1046.8	3	No load	0.98	-0.8	-2
SSGA S&P 500 INDEX	B	Large-cap Blend	B	2233.3	-16	No load	0.17†	-12.1	-12
STANDARD & POOR'S DEPOSITARY RCPT.	A	Large-cap Blend	B	28010.5	25	No load	0.13	-11.9	-12
STANDARD & POOR'S MIDCAP 400 DEPOSITARY RCPT.	B	Mid-cap Blend	B+	4654.7	58	No load	0.25	-0.5	-0
STATE FARM BALANCED 1	B	Domestic Hybrid	C	987.8	-6	No load	0.13	-5.6	-6
STATE FARM GROWTH 1	B	Large-cap Growth	B+	2535.8	-11	No load	0.11	-10.8	-11
STATE STREET RESEARCH AURORA A	A	Small-cap Value	A	1557.0	146	5.75**	1.44†	15.8	15
STATE STREET RESEARCH INVESTMENT TRUST S	C	Large-cap Blend	C	752.4	-26	No load	0.65	-18.1	-18
STEINROE INVESTMENT GROWTH STOCK	C	Large-cap Growth	C	598.5	-30	No load	0.85	-23.9	-23
STEINROE INVESTMENT YOUNG INVESTOR	C-	Large-cap Growth	C-	841.1	-19	No load	1.26	-22.0	-22
STI CLASSIC CAPITAL APPRECIATION TRUST	B+	Large-cap Blend	B+	1136.4	8	No load	1.21	-6.5	-7
STRONG ADVISOR COMMON STOCK Z (bi) 1	B+	Mid-cap Value	C	1624.7	1	No load	1.20	-1.7	-1
STRONG GROWTH & INCOME INV.	B	Large-cap Blend	C	880.2	-21	No load	1.10	-20.1	-20
STRONG GROWTH INV.	C-	All Cap	C-	2028.3	-39	No load	1.20	-34.4	-34
STRONG LARGE CAP GROWTH	C	Large-cap Growth	C	995.5	-36	No load	1.00	-32.3	-32
STRONG OPPORTUNITY INV. 1	A	Mid-cap Blend	B	3516.2	13	No load	1.20	-4.8	-5
STYLE SELECT FOCUS II		Large-cap Growth		599.2	-17	1.00**	2.21†	-14.9	-14
TCW GALILEO SELECT EQUITY I	B	Large-cap Growth	B	979.3	84	No load	0.85	-19.2	-19
TEMPLETON DEVELOPING MARKETS A 1	F	Diversified Emerging Markets	C-	1196.8	-21	5.75**	2.09†	-3.8	-6
TEMPLETON FOREIGN A 1	C-	Foreign	B+	8663.2	-16	5.75**	1.18†	-7.9	-8
TEMPLETON GLOBAL SMALLER COMPANIES A 1	D	World	D	596.3	-16	5.75**	1.37†	-1.7	-2
TEMPLETON GROWTH A 1	B	World	B	11920.8	-2	5.75**	1.11†	0.5	-0
TEMPLETON INSTL. EMERGING MARKETS 1	F	Diversified Emerging Markets	C	1211.0	-25	No load	1.47	-5.0	-5
TEMPLETON INSTL. FOREIGN EQUITY PRIM.	C	Foreign	B+	3576.7	-15	No load	0.83	-12.1	-12
TEMPLETON WORLD A	C	World	C	7012.6	-14	5.75**	1.09†	-8.1	-8
THIRD AVENUE VALUE 1	B+	All-cap	B	2524.3	42	No load	1.09	2.8	2
THORNBURG VALUE A	A	Large-cap Blend	A	1179.7	34	4.50**	1.37†	-8.1	-8
TIAA-CREF GROWTH & INCOME		Large-cap Blend		530.1	-3	No load	0.43	-13.4	-13
TIAA-CREF GROWTH EQUITY		Large-cap Growth		558.1	-18	No load	0.45	-23.0	-23
TORRWAY	B	Large-cap Value	B	1609.2	-10	No load	1.06	-0.5	-1
TURNER MID CAP GROWTH	A	Mid-cap Growth	A	727.4	-18	No load	1.04	-28.4	-28
TWEEDY BROWNE AMERICAN VALUE	B+	Large-cap Value	B+	914.9	0	No load	1.36	-0.1	-0
TWEEDY BROWNE GLOBAL VALUE	A	World	A	3914.5	11	No load	1.38	-4.7	-5
USAA AGGRESSIVE GROWTH	D	Small-cap Growth	C-	1009.3	-32	No load	0.66	-33.4	-33
USAA CORNERSTONE STRATEGY	C	Domestic Hybrid	C-	946.1	-8	No load	1.07	-4.7	-5
USAA GROWTH	D	Large-cap Growth	F	1094.9	-27	No load	0.89	-23.8	-23
USAA GROWTH & INCOME	C	Large-cap Value	C	1050.4	-3	No load	0.85	-6.1	-6
USAA INCOME STOCK	B	Large-cap Value	C	1830.8	-4	No load	0.67	-4.2	-5
USAA S&P 500 INDEX	B	Large-cap Blend	B	2915.2	-4	No load	1.06	-12.1	-12
VAN KAMPEN AGGRESSIVE GROWTH A	C-	Small-cap Growth	C	769.7	-16	5.75**	1.19†	-39.7	-39
VAN KAMPEN COMSTOCK A	A	Large-cap Value	A	3651.4	59	5.75**	0.93†	-1.8	-3
VAN KAMPEN EMERGING GROWTH A 1	C	Mid-cap Growth	B	6005.3	-28	5.75**	0.93†	-32.6	-32

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.

(bf) Formerly Kemper Growth Fund/A. (bg) Formerly Kemper Technology Fund/A. (bh) Formerly Kemper Total Return Fund/A. (bi) Formerly Strong Common Stock Fund.

Equity Funds

ANNUAL TOTAL RETURNS (%)				HISTORY	PORTFOLIO DATA					RISK	TELEPHONE				
5 YEARS		10 YEARS		RESULTS VS. ALL FUNDS	TURNOVER	CASH %	UNTAXED GAINS %	P/E RATIO	TOP 10 STKS. %	LARGEST HOLDING COMPANY (% ASSETS)	LEVEL	BEST		WORST	
PRETAX	AFTERTAX	PRETAX	AFTERTAX									QTR	% RET	QTR	% RET
7.8	7.1	NA	NA	31245	Average	0	-20	24	27	Vodafone (4)	Average	IX 99	30.9	I 01	-17.1
NA	NA	NA	NA	3	Average	2	11	30	27	Citigroup (3)		IX 01	10.5	III 01	-14.7
2.0	0.7	5.0	2.8	43254	Average	3	-11	40	42	General Electric (7)	High	IX 99	29.1	III 98	-22.2
3.6	1.7	7.1	5.4	52155	Average	0	-30	27	25	Vodafone (4)	Average	IX 99	30.5	I 01	-16.0
8.3	7.6	9.4	8.4	11254	Average	5	-14	35	43	General Electric (6)	High	IX 99	28.1	I 01	-21.2
8.8	6.9	10.8	5.3	14513	Average	4	12	25	30	Exxon Mobil (4)	Low	IX 98	18.0	III 01	-14.7
10.3	8.1	13.2	10.1	51155	Low	0	-37	45	44	Microsoft (5)	Very High	IX 99	57.8	III 01	-34.8
7.5	5.0	8.1	5.5	33432	Average	4	6	31	26	U.S. Treas. Notes 05/02 (4)	Low	II 97	13.1	III 01	-9.2
7.0	5.4	11.4	9.0	22443	Low	2	22	22	31	General Electric (5)	Average	IX 98	20.9	III 01	-15.0
-7.6	-7.7	NA	NA	55152	High	NA	-30	14	NA		High	IX 99	31.3	III 98	-27.5
0.8	0.0	4.2	2.9	52254	Average	3	-29	21	15	Deutsche Bank (2)	Average	IX 99	20.9	III 01	-15.5
NA	NA	NA	NA	513	Very Low	1	-7	20	53	Citigroup (14)		III 00	23.6	III 98	-15.4
NA	NA	NA	NA	154	Low	1	-61	45	58	Microsoft (15)		IX 99	31.5	IX 00	-32.6
13.3	11.9	13.6	11.5	15322	Low	NA	13	28	43	Tyco International(6)	Low	IX 98	22.2	III 98	-14.8
13.2	10.6	20.4	17.3	31151	Average	NA	-18	31	40	Microsoft	Very High	IX 98	45.1	III 01	-31.0
7.1	4.3	9.5	6.5	41244	High	NA	-35	32	37	Pfizer	High	IX 98	24.2	IX 00	-25.2
8.4	5.7	10.7	8.1	23523	Average	0	34	23	25	Exxon Mobil (4)	Low	IX 98	16.5	III 98	-11.7
4.1	2.5	NA	NA	43344	Average	0	-3	NA	30	Novartis Ag (4)	Average	IX 99	17.0	III 98	-14.9
16.5	14.8	16.5	14.8	11511	Low	1	57	28	57	Berkshire Hathaway A (37)	Low	II 97	21.5	III 99	-14.4
4.8	3.3	9.6	7.7	44144	Average	10	-14	26	11	Gallagher, Arthur J. & Co.(1)	High	IX 99	34.6	III 01	-25.2
26.3	25.8	18.5	17.8	21112	Very Low	8	24	24	50	Unitedhealth Group (6)	Average	IX 98	37.6	III 01	-22.4
11.3	8.9	11.6	9.4	22422	Average	9	25	20	36	Berkshire Hathaway A (7)	Low	IX 98	17.9	III 01	-12.5
5.7	3.3	NA	NA	11433	Average	0	-8	21	17	Merck (2)	Low	IX 98	14.5	III 01	-10.3
12.9	11.6	NA	NA	43212	Average	4	18	17	23	Worldcom (2)	Low	IX 98	18.2	III 01	-17.6
5.8	4.5	9.8	7.1	32412	Average	1	-1	NA	30	Pfizer (4)	Average	IX 98	19.5	III 01	-15.7
11.3	9.1	11.9	8.3	21234	Very Low	4	22	NA	30	Pfizer (4)	Average	IX 98	23.6	III 01	-15.2
NA	NA	NA	NA	11311	Very Low	0	7	31	46	Pfizer (6)		IX 98	37.5	III 01	-17.2
7.4	4.3	NA	NA	24522	Average	1	-4	20	22	S&P 500 Index Futures 12/01 (6)	Very Low	II 97	10.3	III 01	-11.7
11.2	10.3	14.9	12.8	14512	Average	4	17	17	32	Constellation Energy Group (4)	Low	IX 98	16.3	III 98	-14.5
10.5	9.0	NA	NA	11243	Low	1	1	22	22	General Electric (4)	Average	IX 98	21.4	III 01	-14.7
10.8	10.1	NA	NA	11243	Low	0	-20	43	25	General Electric (4)	Average	IX 98	21.2	III 01	-14.6
15.7	15.1	NA	NA	12412	Low	NA	-7	NA	NA		Average	IX 98	28.0	III 01	-16.6
7.3	5.2	8.7	7.4	30402	Very Low	1	34	23	25	Pfizer (5)	Very Low	IX 98	12.1	I 01	-6.8
9.6	8.9	10.2	9.2	18333	Very Low	0	48	23	37	Johnson & Johnson (6)	Average	IX 98	19.8	I 01	-11.5
21.4	20.9	NA	NA	15211	Low	11	18	30	19	Everest Reinsurance Group (2)	Low	III 97	22.7	III 98	-23.7
9.2	7.4	11.0	8.3	31334	High	3	7	39	28	General Electric (3)	Average	IX 98	20.6	III 01	-17.9
8.8	7.4	10.3	8.3	12245	Average	7	26	30	45	Pfizer (6)	High	IX 99	25.4	III 01	-20.1
6.5	5.8	NA	NA	22244		1	-4	27	39	Johnson & Johnson (5)	High	IX 99	28.2	III 01	-24.6
11.9	9.2	NA	NA	11422	Average	1	16	24	30	Tyco International(4)	Low	IX 98	22.9	III 01	-15.0
12.5	9.6	15.8	13.0	34232	Average	8	10	27	23	Wellpoint Health Networks (2)	Average	IX 99	25.3	III 01	-20.1
10.5	10.1	NA	NA	11344	Low	2	-3	29	29	General Electric (4)	Average	IX 98	23.4	I 01	-17.8
9.5	7.2	NA	NA	31145	Very High	9	-23	34	29	Kohls (3)	High	IX 99	54.8	I 01	-27.4
9.0	6.3	10.5	8.3	31145	Average	11	-30	28	30	General Electric (4)	High	IX 99	42.7	I 01	-26.5
14.5	11.7	15.8	13.5	33222	Average	10	9	23	24	Sprint PCS (2)	Low	IX 01	19.8	III 01	-20.1
NA	NA	NA	NA	153	Very High	NA	-26	48	NA			IX 99	31.6	IX 00	-16.7
12.9	9.9	NA	NA	31234	Average	0	-10	29	59	Progressive Ohio (14)	High	IX 99	31.2	III 01	-25.8
-6.4	-7.0	2.4	1.7	55252	Average	6	-79	14	28	Cemex SA (5)	Very High	IX 99	26.5	IX 97	-24.9
4.6	2.8	8.5	6.7	55232	Low	0	-6	17	20	Cheung Kong Holdings (3)	Low	II 99	15.6	III 98	-17.2
-1.2	-2.5	5.8	3.7	55332	Low	6	8	15	27	Giordano International (4)	Average	IX 01	16.2	III 98	-20.3
8.6	6.1	11.8	9.0	45221	Low	0	8	18	17	H.J. Heinz (2)	Low	II 99	13.4	III 98	-15.2
-6.0	-6.7	NA	NA	55152	Average	1	-65	NA	28	Cemex (5)	Very High	IX 99	28.4	IX 97	-25.7
5.3	3.3	8.8	7.4	44333	Low	NA	-1	19	NA		Average	IX 99	16.8	III 98	-15.9
7.4	5.0	11.4	8.4	34332	Low	7	7	25	19	Cheung Kong Hldgs Ltd (4)	Low	IX 98	15.3	III 98	-14.1
12.5	11.3	15.6	14.6	34411	Low	13	18	16	31	AVX (5)	Low	I 00	17.5	III 98	-14.3
16.5	15.5	NA	NA	12322	Average	6	-1	24	31	Washington Mutual (4)	Low	IX 99	21.6	III 01	-14.5
NA	NA	NA	NA	1533	Low	6	-12	30	29	Freddie Mac Cons. Dsc. Note. (6)		IX 98	23.0	III 01	-14.7
NA	NA	NA	NA	1254	Low	1	-41	37	36	General Electric (7)		IX 98	28.4	I 01	-22.7
12.1	11.2	16.3	15.3	14332	Average	NA	11	32	46	Illinois Tool Works (6)	Average	IX 98	21.3	III 98	-21.3
21.4	20.4	NA	NA	11135	Very High	4	-62	38	17	King Pharmaceuticals (2)	High	IX 99	54.6	III 01	-32.3
12.2	11.3	NA	NA	14512	Very Low	NA	27	11	40	MBIA (7)	Low	II 97	15.7	III 98	-14.6
12.5	11.0	NA	NA	12312	Very Low	NA	11	13	23	Pharmacia (3)	Very Low	IX 98	16.2	III 98	-17.9
8.0	4.5	8.7	6.9	32155	Very Low	NA	-4	38	NA		Very High	IX 99	51.2	I 01	-34.2
4.5	2.7	8.5	6.7	44422	Average	NA	10	24	NA		Very Low	II 97	8.5	III 98	-10.7
0.5	-0.8	5.9	4.6	51355	Average	NA	-19	NA	NA		High	IX 98	26.1	III 01	-25.5
8.2	7.1	NA	NA	24422	Low	NA	21	28	NA		Low	IX 98	17.5	III 98	-17.5
8.4	6.2	10.5	8.2	34523	Low	NA	18	23	NA		Low	IX 98	10.7	III 01	-8.3
10.5	9.9	NA	NA	11343	Average	NA	-12	33	NA		Average	IX 98	21.3	III 01	-14.7
12.9	11.6	NA	NA	41145	Very High	4	-57	24	22	USA Ed (2)	Very High	IX 99	56.8	I 01	-29.1
15.7	12.2	14.5	10.4	22512	High	7	1	16	29	Halliburton (4)	Low	IX 00	15.4	III 01	-13.5
14.8	12.5	15.7	13.6	31145	High	4	-40	36	20	Freddie Mac Cons. Dsc. Note (3)	High	IX 90	61.3	IX 00	-25.3

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

FUND	OVERALL RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF FUND WITHIN CATEGORY)	SIZE ASSETS \$ML.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	2001 RETN. PRE- TAX	AFTER TAX
VAN KAMPEN ENTERPRISE A	C-	Large-cap Growth	C-	1752.9	-23	5.75**	0.89†	-20.7	-20.7
VAN KAMPEN EQUITY INCOME A	A	Domestic Hybrid	A	2159.7	41	5.75**	0.82†	-2.2	-2.2
VAN KAMPEN GROWTH & INCOME A	B+	Large-cap Value	B+	1702.5	32	5.75**	0.88†	-6.1	-6.1
VAN KAMPEN FUND A	C-	Large-cap Growth	C-	2253.7	-25	5.75**	0.87†	-16.2	-16.2
VANGUARD 500 INDEX	B	Large-cap Blend	B	72493.5	-19	No load	0.18	-12.0	-12.0
VANGUARD ASSET ALLOCATION	B+	Domestic Hybrid	B+	7854.3	-9	No load	0.44	-5.3	-5.3
VANGUARD BALANCED INDEX	B+	Domestic Hybrid	B	3075.1	-14	No load	0.22	-3.0	-3.0
VANGUARD CAPITAL OPPORTUNITY	A	Mid-cap Growth	A	4727.7	-3	0.00*	0.62	-9.6	-9.6
VANGUARD EMERGING MKTS. STOCK INDEX (bj)	F	Diversified Emerging Markets	C	840.5	-3	0.00*	0.59	-2.9	-2.9
VANGUARD ENERGY	C	Natural Resources	B+	1208.4	2	0.00*	0.41	-2.5	-2.5
VANGUARD EQUITY INCOME	B+	Large-cap Value	B+	2242.0	-8	No load	0.47	-2.3	-2.3
VANGUARD EUROPEAN STOCK INDEX (bk)	C	Europe	B	4265.5	-19	No load	0.29	-20.3	-20.3
VANGUARD EXPLORER	C	Small-cap Growth	B	4334.5	7	No load	0.71	0.5	0.5
VANGUARD EXTENDED MARKET PORT INV.	C-	Small-cap Blend	D	2966.3	-21	No load	0.25	-9.2	-9.2
VANGUARD GROWTH & INCOME	B	Large-cap Blend	B+	6922.8	-22	No load	0.28	-11.1	-11.1
VANGUARD GROWTH EQUITY	C-	Large-cap Growth	C-	740.4	-18	No load	0.77	-27.4	-27.4
VANGUARD GROWTH INV.	C	Large-cap Growth	B	8500.6	-29	No load	0.22	-13.0	-13.0
VANGUARD HEALTH CARE	A	Health	A	18554.4	-5	0.00*	0.34	-7.2	-7.2
VANGUARD INTERNATIONAL VALUE	C-	Foreign	C	872.3	6	No load	0.53	-14.1	-14.1
VANGUARD LIFESTRATEGY CONS. GROWTH	B+	Domestic Hybrid	B+	2012.5	15	No load		-0.1	-0.1
VANGUARD LIFESTRATEGY GROWTH	B	Domestic Hybrid	C	3714.9	10	No load		-8.9	-8.9
VANGUARD LIFESTRATEGY INCOME	B+	Domestic Hybrid	A	809.6	30	No load		4.1	4.1
VANGUARD LIFESTRATEGY MOD. GROWTH	B+	Domestic Hybrid	B	4227.7	17	No load		-4.5	-4.5
VANGUARD MID CAP INDEX INV.	C	Mid-cap Blend	C	1907.0	32	No load	0.25	-0.5	-0.5
VANGUARD MORGAN GROWTH	C	Large-cap Growth	C	3460.1	-30	No load	0.40	-13.6	-13.6
VANGUARD PACIFIC STOCK INDEX (bl)	F	Diversified Pacific/Asia	B	1407.3	-26	No load	0.38	-26.3	-26.3
VANGUARD PRIMECAP	A	Mid-cap Growth	A	17885.0	-15	No load	0.48	-13.3	-13.3
VANGUARD REIT INDEX	C	Real Estate	C	1209.6	17	0.00*	0.33	12.4	12.4
VANGUARD SELECTED VALUE	C	Mid-cap Value	D	654.8	527	0.00*	0.63	15.1	15.1
VANGUARD SMALL CAP INDEX INV.	C	Small-cap Blend	C-	3305.6	-3	No load	0.27	3.1	3.1
VANGUARD SMALL CAP VALUE INV.		Small-cap Value		718.5	176	No load	0.27	13.7	13.7
VANGUARD STAR	B+	Domestic Hybrid	B+	8132.6	5	No load		0.5	-1.1
VANGUARD STRATEGIC EQUITY	B	Mid-cap Blend	C	835.4	19	0.00*	0.49	5.4	5.4
VANGUARD TAX-MGD. CAP APP	C	Large-cap Blend	C	1785.0	-31	0.00*	0.19	-15.3	-15.3
VANGUARD TAX-MGD. GROWTH & INCOME	B	Large-cap Blend	B	1705.2	-25	0.00*	0.19	-11.9	-11.9
VANGUARD TOTAL INTL. STOCK INDEX	C-	Foreign	C-	2854.5	3	No load		-20.2	-20.2
VANGUARD TOTAL STOCK MARKET INV.	C	Large-cap Blend	C	15559.7	-6	No load	0.20	-11.0	-11.0
VANGUARD U.S. GROWTH	D	Large-cap Growth	D	9543.1	-42	No load	0.44	-31.7	-31.7
VANGUARD UTILITIES INCOME	B	Utilities	C	887.9	-24	No load	0.37	-19.4	-19.4
VANGUARD VALUE INV.	B	Large-cap Value	C	3013.5	-9	No load	0.22	-11.9	-11.9
VANGUARD WELLESLEY INCOME	A	Domestic Hybrid	A	6514.7	3	No load	0.31	7.4	7.4
VANGUARD WELLINGTON INV.	B+	Domestic Hybrid	B+	21883.9	-3	No load	0.31	4.2	4.2
VANGUARD WINDSOR	B	Large-cap Value	B	15798.6	3	No load	0.31	5.7	5.7
VANGUARD WINDSOR II INV.	B	Large-cap Value	B	22105.0	-6	No load	0.37	-3.4	-3.4
VANGUARD WORLD INTL. GROWTH	C-	Foreign	B	5030.4	-30	No load	0.61	-18.9	-18.9
VANTAGEPOINT AGGRESSIVE OPPORTUNITY		Small-cap Blend		693.4	-11	No load	1.24	-13.8	-13.8
VANTAGEPOINT ASSET ALLOCATION		Domestic Hybrid		838.9	-16	No load	0.78	-5.4	-5.4
VANTAGEPOINT GROWTH		Large-cap Blend		2508.5	-23	No load	0.94	-15.2	-15.2
VICTORY DIVERSIFIED STOCK A	B+	Large-cap Blend	A	1102.5	16	5.75**	1.10	0.9	0.9
WADDELL & REED ADV. ACCUMULATIVE A	A	Large-cap Value	A	2096.3	-17	5.75	1.04†	-15.4	-15.4
WADDELL & REED ADV. CORE INVMNT. A (bm)	B	Large-cap Growth	B+	6439.4	-21	5.75	0.98†	-15.3	-15.3
WADDELL & REED ADV. INTL. GROWTH A	C-	Foreign	B	1004.9	-26	5.75	1.44†	-22.4	-22.4
WADDELL & REED ADV. NEW CONCEPTS A	C	Mid-cap Growth	B	1164.0	-24	5.75	1.44†	-18.1	-18.1
WADDELL & REED ADV. RETIREMENT SHARES A	C	Domestic Hybrid	D	989.5	-18	5.75	1.11†	-12.7	-12.7
WADDELL & REED ADV. SCIENCE & TECHNOLOGY A	A	Technology	A	2533.4	-26	5.75	1.32†	-13.4	-13.4
WADDELL & REED ADV. VANGUARD A	C	Large-cap Growth	C	1800.7	-28	5.75	1.11†	-24.7	-24.7
WASATCH CORE GROWTH	A	Small-cap Blend	A	1064.1	240	0.00*	1.32	28.8	27.7
WASATCH SMALL CAP GROWTH	A	Small-cap Growth	A	796.2	272	0.00*	1.36	24.2	23.0
WASHINGTON MUTUAL INVESTORS A	B+	Large-cap Value	B	48135.1	6	5.75**	0.65†	1.5	0.8
WEITZ PARTNERS VALUE	A	All-cap	A	2789.6	57	No load	1.13	-0.9	-1.4
WEITZ VALUE	A	All-cap	A	4150.2	43	No load	1.13	0.2	-0.4
WELLS FARGO ASSET ALLOCATION A	B	Domestic Hybrid	C	1041.7	-12	5.75**	0.99	-7.2	-8.1
WELLS FARGO DIVERSIFIED EQUITY I	B	Large-cap Blend	B	1526.5	-17	No load	1.00	-12.5	-12.5
WELLS FARGO EQUITY INCOME I	B	Large-cap Value	B	1250.1	-9	No load	0.85	-5.4	-6.3
WELLS FARGO GROWTH BALANCED I	A	Domestic Hybrid	A	1259.0	20	No load	0.93	-2.9	-4.0
WELLS FARGO INDEX I	B	Large-cap Blend	B	815.8	-10	No load	0.25	-11.9	-12.0
WELLS FARGO LARGE COMPANY GROWTH I	B+	Large-cap Growth	A	1286.4	-14	No load	0.97	-21.6	-21.6
WHITE OAK GROWTH	C-	Large-cap Growth	C-	3671.3	-33	No load	0.96	-39.1	-39.1
WM BALANCED B	B+	Domestic Hybrid	B	705.3	32	0.00**	1.77†	-1.1	-2.0
WM CONSERVATIVE GROWTH B	B	Domestic Hybrid	C	881.5	19	0.00**	1.77†	-4.9	-5.8

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available. NM=Not meaningful.

(bj) Formerly Vanguard Intl. Equity Index Fund: Emerging Mkts. (bk) Formerly Vanguard Intl. Equity Index Fund: European. (bl) Formerly Vanguard Intl. Equity Index Fund: Pacific. (bm) Formerly Waddell & Reed Advisors Income Fund/A.

Equity Funds

ANNUAL TOTAL RETURNS (%)				HISTORY	PORTFOLIO DATA						RISK		TELEPHONE		
5 YEARS		10 YEARS		RESULTS VS. ALL FUNDS	TURNOVER	CASH %	UNTAXED GAINS %	P/E RATIO	TOP 10 STKS. %	LARGEST HOLDING COMPANY (% ASSETS)	LEVEL	BEST		WORST	
PRETAX	AFTERTAX	PRETAX	AFTERTAX									QTR	% RET	QTR	% RET
8.2	4.3	10.4	7.6	323411	High	3	-13	23	24	Microsoft (4)	High	I 98	24.6	I 01	-21.5
13.4	10.6	13.7	11.3	323412	Average	7	4	19	22	S&P 500 Index Futures 09/01 (3)	Very Low	II 97	12.9	III 98	-7.9
13.2	10.6	14.1	11.2	223412	High	4	4	19	26	Bank America (3)	Low	I 98	15.9	III 98	-11.5
5.0	3.4	9.0	5.7	113411	High	5	-1	21	26	Freddie Mac Cons. Dsc. Note (4)	Average	I 98	20.5	I 01	-16.5
10.7	10.1	12.6	12.1	113443	Low	0	23	29	NA	General Electric	Average	I 98	21.4	III 01	-14.7
10.0	8.9	12.0	10.0	111111	Average	0	6	29	NA	IBM	Very Low	I 98	14.3	I 01	-9.3
9.2	8.0	NA	NA	323432	Low	1	6	30	NA	Citigroup	Very Low	I 98	12.7	III 01	-7.8
10.7	10.3	NA	NA	511113	Very Low	2	4	38	NA	Pharmacia	High	I 99	37.6	III 01	-23.9
-5.0	-5.7	NA	NA	551152	Low	0	-40	14	NA	Samsung Electronics	High	I 99	28.5	III 01	-22.0
8.0	6.6	12.5	11.0	113412	Very Low	3	26	12	NA	Philips Petroleum	High	III 97	16.1	III 98	-14.2
11.2	9.5	13.0	11.1	125112	Low	2	28	21	NA	Exxon Mobil	Low	I 98	13.2	III 99	-8.4
5.4	5.7	9.9	9.2	111111	Very Low	0	3	NA	NA	Astrazeneca Group PLC	Average	I 98	20.4	I 01	-15.6
12.3	10.2	13.0	10.9	442221	Average	5	7	57	NA	Caremark	High	I 99	30.0	III 01	-21.7
7.5	5.3	11.1	9.3	202441	Low	0	-19	37	NA	Berkshire Hathaway	High	I 99	29.6	III 01	-21.0
11.4	9.7	13.2	11.2	113443	Average	2	-1	23	NA	General Electric	Average	I 98	20.6	III 01	-15.0
9.2	5.9	NA	NA	111155	Very High	1	-71	53	NA	Pfizer	High	I 99	39.7	I 00	-29.0
11.1	10.6	NA	NA	111253	Low	0	-9	34	NA	General Electric	Average	I 98	24.6	I 01	-17.5
23.6	21.7	19.9	18.0	214412	Very Low	1	37	45	NA	Pharmacia	Very Low	II 97	19.1	I 01	-12.6
2.0	0.3	5.3	3.2	511111	Average	3	-7	15	NA	Nestle	Average	I 98	20.6	III 98	-15.7
8.5	6.9	NA	NA	434422	Very Low	0	5	NA	NA	Total International Stock Index	Very Low	I 98	8.8	III 01	-4.1
8.5	7.5	NA	NA	323432	Very Low	0	1	NA	NA	Total Bond Market Index Fund	Low	I 98	17.3	III 01	-11.8
8.4	6.5	NA	NA	435521	Low	0	2	NA	NA	Total Stock Market Index	Very Low	II 97	6.1	I 01	-0.8
8.6	7.3	NA	NA	323432	Very Low	0	3	NA	NA	Total International Stock Index	Very Low	I 98	13.1	III 01	-7.9
NA	NA	NA	NA	4112	Low	0	1	27	NA	Genzyme	Average	I 98	28.4	III 01	-16.5
10.1	7.5	12.1	9.5	111155	Average	1	-11	36	NA	AOL Time Warner	Average	I 98	25.9	III 01	-20.8
-8.1	-8.4	-2.5	-2.8	501155	Very Low	0	-53	NA	NA	Honda Motor	High	I 98	26.5	I 97	-20.7
17.0	15.8	17.6	16.4	112223	Very Low	8	23	33	NA	Pharmacia	Average	I 98	28.8	III 01	-21.7
6.2	4.0	NA	NA	355111	Low	1	2	17	NA	Equity Office Properties	Low	III 97	11.5	III 98	-10.4
6.6	5.8	NA	NA	455111	Low	9	5	19	NA	Dana	Average	I 98	17.5	III 98	-27.2
8.4	6.5	12.3	10.5	253311	Low	0	-3	35	NA	Triquint Semiconductor	High	I 01	20.9	III 01	-20.7
NA	NA	NA	NA	5111	Average	0	5	22	NA	Smithfield Foods	Average	I 01	21.4	III 98	-21.3
10.2	7.8	11.5	9.2	334421	Low	0	14	NA	NA	International Growth Fund	Very Low	I 98	11.5	III 98	-8.1
11.4	9.7	NA	NA	203311	Average	0	6	16	NA	Tenet Healthcare	Average	I 98	21.3	III 98	-20.7
10.6	10.4	NA	NA	311344	Low	0	27	31	NA	General Electric	Average	I 98	25.4	III 01	-18.6
10.7	10.3	NA	NA	113443	Very Low	0	11	29	NA	General Electric	Average	I 98	21.4	III 01	-14.7
0.1	-0.5	NA	NA	532444	Very Low	0	-22	NA	NA	Individual Emerging Markets	Average	I 98	20.5	III 01	-14.9
9.7	9.2	NA	NA	113442	Low	0	1	30	NA	General Electric	Average	I 98	21.5	III 01	-15.9
3.3	1.7	5.0	6.7	213355	High	1	5	43	NA	General Electric	High	I 98	24.7	I 01	-31.0
7.2	5.0	NA	NA	323411	Average	3	-5	17	NA	FPL Group	Low	III 00	13.6	III 01	-12.5
9.4	7.6	NA	NA	113443	Low	0	-7	24	NA	Exxon Mobil	Average	I 98	17.5	III 01	-16.3
10.0	7.1	10.4	7.7	323411	Low	2	7	15	NA	Weyerhaeuser	Very Low	III 97	7.4	III 99	-3.1
10.8	8.1	12.1	9.8	323421	Low	1	19	22	NA	Alcoa	Very Low	II 97	12.2	III 01	-5.7
10.6	8.1	14.4	11.4	344411	Average	2	18	19	NA	Citigroup	Average	I 01	14.4	III 98	-19.4
10.4	8.2	13.5	11.4	113412	Low	3	18	19	NA	Philip Morris	Low	I 98	14.9	III 99	-13.6
2.7	1.6	7.5	5.6	523444	Average	4	-3	19	NA	Nippon Telegraph and Telephone	Average	I 98	21.8	III 01	-16.0
NA	NA	NA	NA	11	Low	0	-22	24	14	Caremark Rx (2)	Average	I 99	39.9	III 01	-30.4
NA	NA	NA	NA	32	Low	NA	-26	23	NA	Microsoft (3)	Average	I 01	8.2	I 01	-9.4
NA	NA	NA	NA	34	Average	0	-26	28	22	Microsoft (3)	Average	I 98	26.7	III 01	-20.6
14.3	11.1	15.3	12.0	223321	High	8	5	23	31	SBC Communications (3)	Average	I 98	17.6	III 01	-14.6
15.2	10.9	14.3	10.5	223311	Very High	17	-16	20	35	Pfizer (5)	Low	I 99	24.9	I 01	-12.6
11.3	8.3	13.0	10.8	323421	Very Low	2	15	24	29	Target (4)	Low	II 97	18.7	III 01	-14.6
5.4	2.4	9.4	5.9	421544	High	30	-33	24	26	Suez (4)	Average	I 99	46.7	III 98	-17.3
13.0	10.5	12.8	11.0	411144	Very Low	27	-1	28	29	Concord Efs (4)	High	I 98	46.2	III 01	-21.5
8.8	5.9	10.2	7.5	442333	Very High	7	-24	20	23	American International Group (3)	Average	I 98	28.9	III 01	-17.6
20.9	17.2	17.4	14.8	511143	Low	23	10	25	30	Guidant (4)	High	I 99	61.7	I 01	-19.9
11.0	8.6	11.0	8.7	311132	Average	9	10	25	43	Philip Morris (8)	Average	I 99	31.1	I 01	-21.9
22.3	20.7	18.3	15.9	303111	Low	6	18	24	55	Rent-a-Center (8)	Average	II 01	30.7	III 98	-23.4
22.0	18.8	17.3	15.0	332111	Low	20	22	33	30	Ameripath (5)	Average	I 01	32.0	III 98	-23.8
12.2	10.0	14.1	12.0	125211	Low	3	19	21	22	Bank of America (4)	Low	II 97	14.4	III 99	-9.4
21.8	19.6	NA	NA	113412	Low	27	7	NA	42	Liberty Media (6)	Very Low	I 98	16.6	III 01	-11.0
21.0	18.8	18.0	15.9	113412	Low	23	10	NA	41	Liberty Media (6)	Very Low	I 98	16.5	III 01	-11.1
9.6	6.9	10.6	8.0	323432	Average	2	-15	23	23	U.S. Treas. Bonds 11/01 (3)	Low	I 98	16.2	I 01	-8.9
9.7	8.5	NA	NA	233311	Average	5	27	21	20	Pfizer (3)	Average	I 98	19.9	III 01	-14.6
9.5	8.5	NA	NA	224422	Very Low	2	16	20	37	St Paul (5)	Low	I 98	15.7	III 98	-10.4
11.7	9.9	NA	NA	323422	Average	8	10	21	15	Pfizer (2)	Very Low	I 98	16.9	III 01	-9.1
10.4	9.2	NA	NA	113443	Very Low	3	32	23	26	General Electric (4)	Average	I 98	21.3	III 01	-14.7
14.7	14.0	NA	NA	111224	Very Low	1	-7	33	55	Microsoft (7)	High	I 98	31.6	I 01	-22.8
10.5	10.4	NA	NA	311225	Very Low	0	-51	NA	70	Eli Lilly (9)	High	I 98	37.5	I 01	-33.3
9.3	7.5	NA	NA	533332	Low	5	-2	NA	96	WM Growth & Income I (24)	Very Low	I 99	15.2	III 98	-8.7
10.1	8.5	NA	NA	522332	Low	6	-2	22	100	WM Growth & Income I (32)	Low	I 99	21.9	III 01	-12.9

Data: Standard & Poor's



FOOTBALL

THE EGGHEAD IN THE OWNER'S BOX

Philly's Jeff Lurie failed at films, but he's pretty good at pigskin

When NFL owners meet, the armchairs quickly fill with tycoons of businesses ranging from consumer credit to used cars. It may be a gathering of big heads—but not eggheads. In fact, Philadelphia Eagles owner Jeffrey Lurie is the only PhD in the room.

Any doubts about whether the resident brainiac can win football games, though, have been put to rest. Leaning on Andy Reid, last year's NFL coach of the year, and quarterback Donovan McNabb, the Eagles have a shot at the Super Bowl. After logging their second straight 11-5 season, they thumped Tampa Bay on Jan. 12 by 31-9 to move to the second round of postseason play. Two more victories and the team heads for New Orleans—its first championship appearance in 21 years.

Lurie and his aides have been no slouches on the sidelines, either. Last March, the Eagles moved into the NovaCare Complex, a \$37 million training complex. Two months later, ground was broken for a \$500 million stadium set to open in South Philly in 2003—with nearly \$200 million of the tab picked by the

city and state. Says former Philly Mayor Ed Rendell: "When the Eagles are in the playoffs...you could raise the wage tax and nobody'd notice."

The slight, contemplative Lurie, who bought the Eagles in 1994 for about \$195 million, then a record for a sports franchise, sometimes behaves more like a Peace Corps volunteer than a football owner. In the NovaCare Complex lobby, he has installed a hall of heroes photo display honoring Martin Luther King Jr., Mother Teresa, and Jonas Salk. "Jeffrey is different and distinct," says NFL Commissioner Paul Tagliabue. "But he also comes from a family with a very deep business tradition."

Lurie grew up in Boston, the grandson of Philip Smith, a movie-theater operator whose General Cinema made a fortune. The family parlayed that into



JEFFREY LURIE

BORN 1951, Boston.

EDUCATION BA from Clark University; MS in psychology from Boston University; PhD in Social Policy from Brandeis University.

MOVIE CREDITS Lurie's Hollywood film company

produced *V.I. Warshawski*, *Sweet Hearts Dance*, *I Love You to Death*, and *State of Emergency*.

WHY HE BOUGHT A FOOTBALL TEAM "I thought the value only would go up, and I'd have something I'd

even more lucrative stakes in such companies as Neiman Marcus Group and Harcourt General. Sold last year to American Dutch publisher Reed

sevier for \$4.5 billion.

For a kid, the movie business has perks—like free passes for his friends. But Lurie's most vivid childhood memories revolve around sports—often games he attended with his father, Morris, who died of kidney cancer in 1961 when young Jeff was 9.

After getting a PhD in social psychology, Lurie opened Chestnut Hill Productions and went to Hollywood to champion films with a social wallop. But most of Chestnut Hill turned out turkeys and got walloped. As setbacks mounted, Lurie began looking for a new career. "It's like somebody from a family of doctors who goes into medicine and covers he should have been a painter," says John Bard Manulis, who worked with Lurie on several films.

After a losing bid to Robert Kraft for the New England Patriots, Lurie contacted Norman Braman, then owner of the Eagles. He startled Braman with a request—rare for a prospective owner—to send him game films from the previous year. "That's Jeffrey. He's very knowledgeable about the game," says New York Giants co-owner Roy Tisch, a friend of Lurie's family.

While Lurie insists he's no football expert, his office in the NovaCare Complex overlooks the manicured practice fields, allowing him to watch daily workouts. And after each game, he quits. Reid. Former Eagles staffers grumble when asked about the boss's butting in, though Lurie gives the impression of always hands-off. "When an owner starts to evaluate talent," he says, "he reaches some irrational decisions at times. There is, however, one decision Lurie would love to be making in February: how to find room next to Mother Teresa for a Super Bowl trophy.

By Mark Hyman in Philadelphia

emotionally love." He paid about \$195 million for the team in 1994; the Eagles now are worth \$760 million.

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COMMENTARY

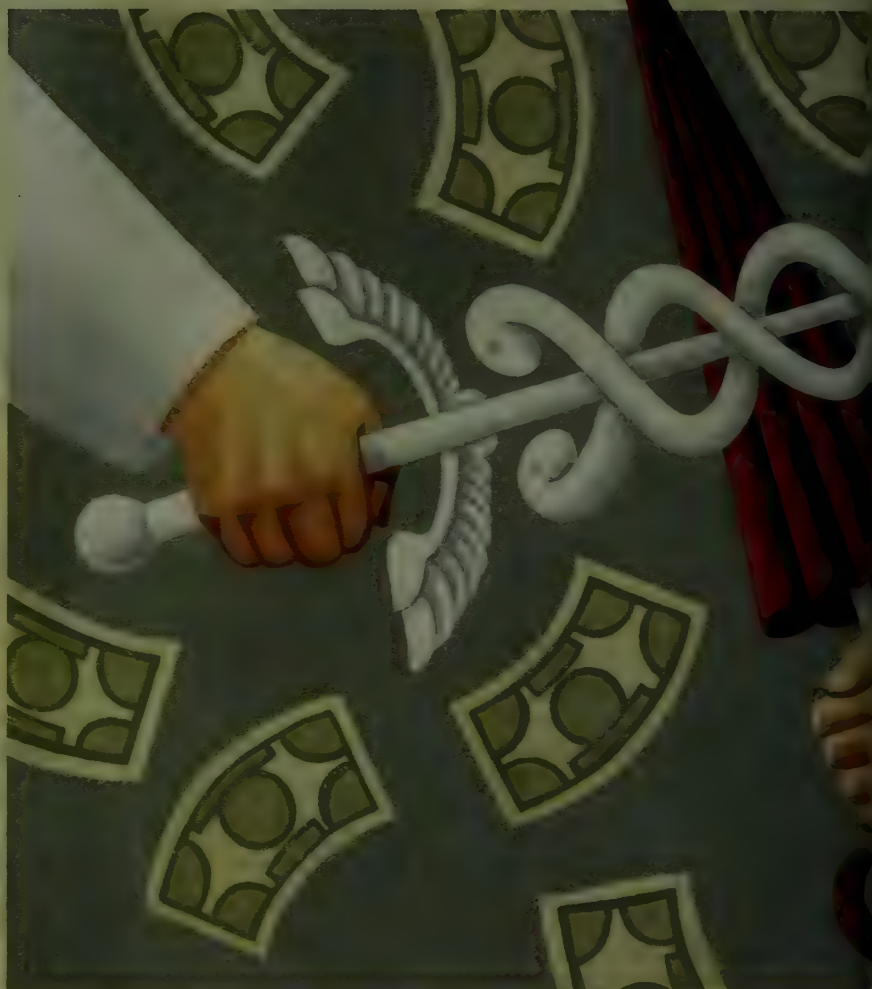
By Joseph Weber

THE NEW POWER PLAY IN HEALTH CARE

Last fall, some 200,000 Northern Californians had reason to reach for the Prozac. As members of a health insurance plan run by Woodland Hills-based Health Net Inc., they feared being shut out of many local hospitals if they got sick or hurt over the next year. That's because Health Net was balking at the 25% annual payment hikes demanded by Sutter Health, a mammoth health-care provider with 26 hospitals and 5,000 doctors serving San Francisco and 100 other cities across half the Golden State. And Sutter was playing rough: It yanked its own 30,000 employees out of Health Net and pounded the insurer in newspaper ads, suggesting that perhaps patients should switch health plans.

Sutter's tactics scared the daylighters out of Health Net members, prompting some 20,000 to jump to other insurers, says Health Net Senior Vice-President David Olson. In the end, his company, which insures 5.5 million in 13 states, agreed on a two-year contract with Sutter. Health Net then jacked up its premiums by about 15%. Sutter spokesman Bill Gleeson defends the ads as a necessary early warning for patients when talks are going poorly.

A little cutthroat for folks in the healing profession? No doubt. Yet such brawls are increasingly common as the growth of regional monopolies like Sutter dramatically boosts the pricing power of health-care providers once again. Throughout much of the 1990s, managed care gave insurers like Health Net the clout to dictate ever-stingier terms to hospitals, doctors, and other health-care providers. The controls cooled years of feverish medical inflation and helped hold health-care cost hikes in the single digits. Now costs are soaring upward again, thanks to the waves of mergers and closings that have consolidated hospitals into ever-larger chains



like Sutter, with much more pricing power (charts). Already, family premiums are jumping up, and states are struggling to pay for crushing Medicaid expenses. "We have instituted survival of the fittest," warns Alan Sager, a professor of health services at Boston University.

The public backlash against the gatekeepers has bolstered providers' growing strength. As patients chafe at restrictions on which doctors they can see, they have stampeded out of HMOs. Just 23% of workers are covered by

HMOs today, vs. 31% in 1996, according to the Kaiser Family Foundation. In contrast, 70% now use less restrictive preferred-provider organization point-of-service plans, up from 55% in 1996. As a result: Americans have gained patients' rights, but at the expense of giving providers more leeway to raise prices through price increases.

No relief is in sight. With more health care pretty much spent as a share of the economy, rising costs, the nation's health-care costs may hit 16% of gross domestic product by 2010, vs. 13.4% now, according to the Kaiser Family Foundation.

**KEEPING
PROVIDER
COSTS
IN LINE**

ANTITRUST Sic the feds and states on hospitals and other providers, which are using their growing market power to ratchet up prices. Officials could apply long-established antitrust principles that measure excessive concentration in local markets.

PRICE TRANSPARENCY Consumers usually have no way to tell what hospitals and doctors charge for services. These prices should be made public, allowing consumers to make choices about health-care purchases just as they do for any other services.

h & Human Services Dept. ns should get used to the fact h-care costs are going to take urger share of GDP," says University health-care econo E. Reinhardt.

are a few ways to cool off the price fever. For one, providers and insurers should make their prices public, so companies can prod employees to consider cost when they seek medical care. Washington and the states also should use the antitrust stick to dampen some of the new provider clout. On Jan. 4, the Massachusetts Attorney General opened an antitrust probe of statewide physicians and hospitals.

To see why this is a good idea, just look at providers' growing power. The number of hospitals has shrunk by about 9% since 1990, to 4,915, even as the U.S. population has ex-

y 13%. Massachusetts, for ex- s fewer than 70 hospitals, m about 90 a decade ago. hospitals have closed in North- ifornia in recent years. Those g have consolidated into ever- rains: Just four companies man- of beds in Cleveland, vs. 41% or instance. In 10 of 12 repre- markets across the U.S., four s control most patient admis- s the Washington-based Cen- studying Health System Change at's the level defined as "con-

FORCES Insurers and s should offer health plans o consumers the ability to und among individual and doctors. That would ntroduce true market condi- the industry.

centrated" by the Justice Dept. for the purposes of antitrust regulation.

Hospital chains are flexing their new muscle. Spending on hospitals jumped by 5.1% in 2000, vs. an average of 3.5% from 1994 to 1999, according to HHS figures released on Jan. 7. Hospitals accounted for 43% of the increase in employer health-care spending, almost double their 1999 share, HSC concluded. They even outstripped prescription-drug spending, which accounted for 29% of employers' higher medical costs.

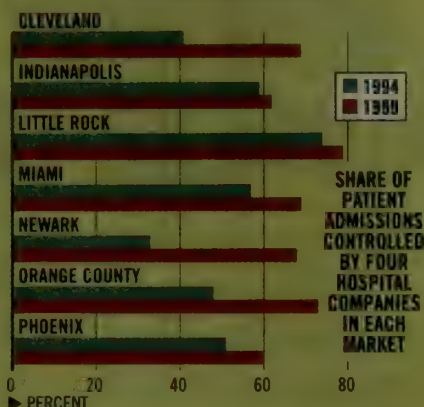
Indeed, bare-knuckle battles have broken out across the country. One involved Partners HealthCare System Inc., a Boston hospital group that controls a fifth of all hospital beds in eastern Massachusetts. In 2000, it stormed away from the bargaining table with Tufts Health Plan, which serves 900,000 people, after the insurer refused 30% increases over three years. Partners posted notices at Mass General saying that Tufts cards were no longer acceptable. Finally, Tufts agreed to Partners' terms, bringing 9% to 12% premium hikes for Tufts customers. Partners defends its price push, arguing that it's necessary to provide good medical care, especially at teaching hospitals. "We're not trying to be profligate, but we do have to have margins to invest in research and education," says Partners CEO Samuel O. Thier.

Like hospitals, doctors are beginning to see strength in numbers. In recent years, many have formed groups to pool their negotiating power. In Seattle, groups of specialists refused to renew contracts in 2000 with 1 million-member Regence BlueShield, the biggest insurer in Washington State, in a dispute over fees. As a result, Regence was shut out of big swaths of Seattle for months.

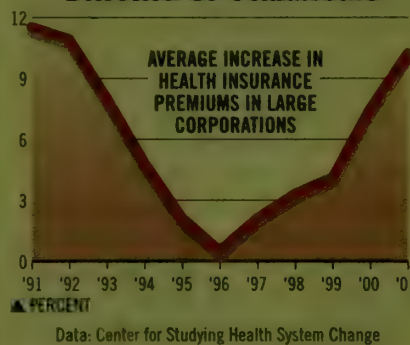
In one high-profile fight, a 75-doctor group refused to handle Regence patients for six months while the parties dickered. The docs' grievance: Government reimbursement schemes, used as benchmarks by many private health plans, had pushed down their payments. The group, Proliance Surgeons, won the battle, lifting Regence's doctor expenses by up to 12% in 2002.

Providers like Sutter and Partners explain the price hikes as an effort to restore the quality of care. While some agree that managed care wrung inefficiencies out of the system, they argue that the controls cut flesh along with the fat. Still, the exceptional power they have garnered seems all too easy to abuse.

AS HOSPITALS' MARKET CLOUT GROWS...



...THEY'RE CHARGING MORE, DRIVING UP PREMIUMS



What's to be done? For one thing, antitrust authorities should look at markets where providers wield disproportionate influence. Does it really promote competition for 11 Boston area hospitals to form a united front? Another step would be to make costs public, something hospitals, doctors, and insurers generally refuse to do. For a truly competitive system, consumers must weigh prices when they choose what health care to buy. Finally, we all may have to learn how to shop for health care, paying as much mind to doctor bills as we do to, say, car prices. PacifiCare Health Systems has begun offering a lower-cost plan in which patients shoulder co-payments of up to \$400 a day if they go to higher-cost hospitals but pay nothing extra for lower-priced ones.

Such efforts may prove to be only Band-Aids. Systems that exclude people based on price also raise the specter of unequal care. But as things now stand, the U.S. tolerates a system in which everyone pays exorbitantly and there are few checks on prices. Unless the private sector can come up with workable solutions, the clamor for a heavier government hand is sure to rise anew.

With John Cady in New York

A NEW WAY TO SQUEEZE THE WEAK?

Insurers' use of credit scores to set premiums is spurring outrage—and legal and legislative action

Heather Lowe, a 32-year-old secretary in Bellingham, Wash., reeled when she opened her auto insurance bill in November. Farmer's Bureau was raising her annual premiums by 46%, to \$1,665, a blow for the divorced mother of two. She had paid all her previous premiums on time. True, she had had an accident some years before, but the company didn't raise her rates then. Why now? Her agent was no help. Then she got suspicious. The renewal notice showed Farmer's had checked her credit. Investigating, she traced the credit problem to her ex-husband's bankruptcy. Her name was still on a joint mortgage and some credit cards. But that didn't answer the basic question: What did her credit rating have to do with the odds she would wreck her car? Unable to pay the higher rate, Lowe let her insurance lapse temporarily. "What happens to people like me who are not at fault and don't have a bad driving record?" she sighs.

An increasing number of Americans are getting similar jolts from their home and auto insurers. State laws generally require companies to cover anyone who represents an acceptable risk, and pre-

miums must reflect the statistical odds that they'll file claims based on such criteria as age, place of residence, and driving record. But over the past three years—a period when premiums and profits were under pressure—U.S. insurers have quietly ramped up the use of a controversial new risk criterion: credit history. According to a July, 2001, study by Conning & Co., a Hartford industry research firm, 92% now use it as a factor in calculating premiums on home and auto insurance.

The practice has already inspired a major backlash. Mounting consumer complaints have aroused state regulators' suspicions that it's a creative new form of redlining: illegal discrimination against low-income, elderly, and minority customers whose credit record may be less than pristine. Using credit scoring "is discriminatory," says Washington State Insurance Commissioner Mike Kreidler. "You can pay two times as much for your insurance as your next-door neighbor because of your credit score." More than 20 states are investigating the practice. In San Antonio, six people filed a class action in federal court alleging that Allstate Insurance Co. uses credit criteria to discriminate against minority customers. Allstate denies the allegations.

THE CREDIT-RATING DEBATE

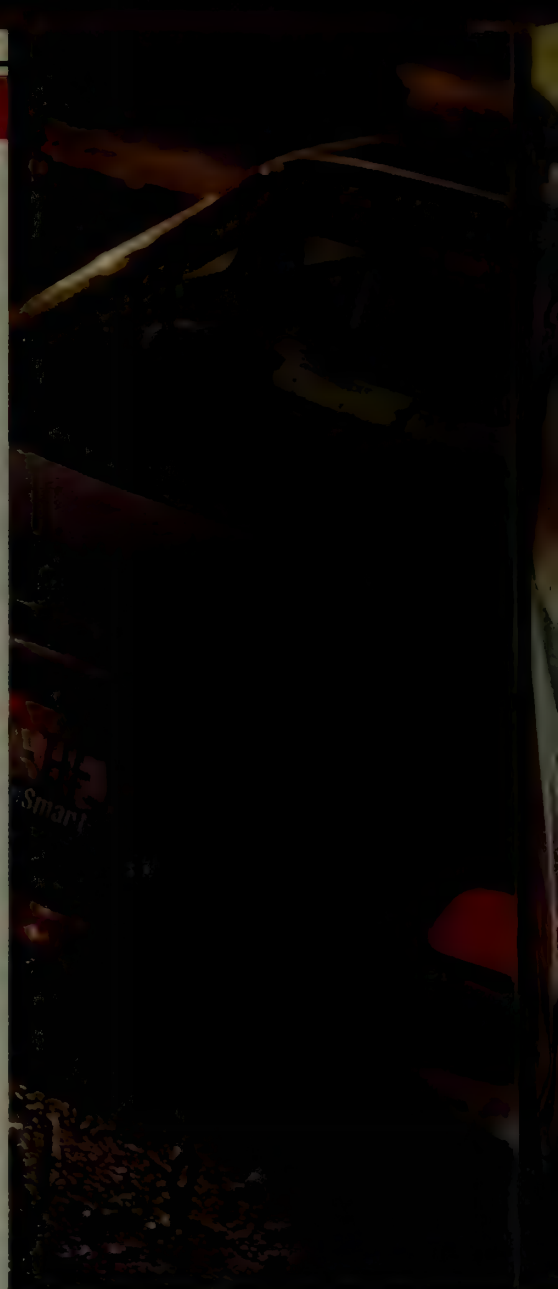
INSURERS SAY

- Individuals with bad credit tend to make more claims on policies
- A good financial record can reduce a policyholder's premiums
- Using credit ratings isn't discriminatory because rich people have bad scores, too

CRITICS SAY

- There's no rational link between credit ratings and claims records
- Companies use the practice to get around regulators' limits on premium hikes
- This is a new excuse for denying coverage to the poor, elderly, and minorities

Data: BusinessWeek



The controversy revives ugly memories. For decades, insurers routinely drew a metaphorical red line around poor or minority neighborhoods, refusing to insure residents' homes or cars. The practice was supposed to be outlawed by the Fair Housing Act of 1968, but redlining never completely went away. In 1997, Nationwide Insurance, Allstate, and State Farm Insurance settled a redlining complaint with the Housing & Urban Development Dept. by agreeing to fund minority-homeowner programs. Consumer advocates say insurers always try to avoid covering those they see as less desirable customers. "Redlining has its own momentum," says Al Scudieri, a former agent who investigates redlining. Tampa law firm.

Major property and casualty insurers—including Allstate, Progressive, and State Farm—insist that credit data are a meaningful adjunct to conventional underwriting procedures, and they are used to



Insurers found a "magic potion" to justify higher premiums, says an industry consultant

LOWE'S CAR PREMIUMS JUMPED 46%

tionwide. "We want to determine the extent to which credit scoring may be responsible for some of these staggering rate increases," says Montemayor. Rates in Texas have risen over 30%. Lowe's experience backs that up. After Farmer's November shocker, she shopped around and was given a quote for comparable coverage that didn't involve credit scoring for only \$1,020 from a local company, Columbia Agencies Inc. She expects to have enough saved to start coverage at the end of January. A Farmer's spokeswoman says factors other than credit may have boosted Lowe's rates.

Insurance industry executives concede that credit-scoring is a lightning rod for critics. "We expect to see legislative and

regulatory proposals in at least 25 states that will ban or restrict the use of credit scores for underwriting and rating purposes," says Sam Sorich, vice-president of the National Association of Independent Insurers, a lobbying group. He and others say they'll fight such legislation because credit scoring is not only legal under the Federal Fair Credit Reporting Act of 1970 but its validity as a predictor of claims has been well documented. The practice really caught on in 1999 after several studies, from the Virginia Bureau of Insurance and the credit scoring agency Fair, Isaac & Co., among others, lent support to the notion that poor credit scores correlated with higher claims. With premiums under pressure, insurers were looking for ways to cut claims and justify higher rates. "The

use of credit reports was the magic potion that would help them squeeze those extra profits," says Wayne D. Holdredge, a principal at financial-services consultants Tillinghast-Towers Perrin.

Yet even some industry insiders have misgivings. Insurance sales agents complain that they're losing loyal customers. And the National Association of Professional Allstate Agents has condemned credit scoring as discriminatory. "Every day, hundreds, if not thousands, of people are affected negatively by their credit score," fumes Bill Murphy, an independent agent in Austin, Tex.

Allstate agent Raymond Gonzalez says he couldn't defend a 25% hike the company imposed in May on his customer, José C. DeHoyos, based on his credit record. The 65-year-old Hispanic-American from Somerset, Tex., has filed only one claim in 26 years as an Allstate customer—for hailstorm damage to his car five years ago. He's now the lead plaintiff in the San Antonio class action. DeHoyos' attorney, Christa L. Collins, says the only blemishes on his credit history are two late payments, totaling \$131, to a hospital and a gas station. Says Allstate

spokesman Michael Trevino: "It could be a perfect credit report in his mind because he might have always paid on time, but there are other variables, like number of credit accounts and outstanding balances relative to credit limits that are considered in our score."

Insurance regulators say what makes them particularly suspicious is insurers' refusal to explain how they use credit histories, which are notoriously inaccurate and hard to interpret. Back in 1980, Aetna Inc.—which sold its property and casualty business in 1996—admitted past discrimination with ads showing a man eating crow. Given the groundswell against credit scoring, other insurers may soon see the same dish on the menu.

By Brian Grow in Atlanta and Pallavi Gogoi in Chicago

INSURERS HAVE A HISTORY OF REDLINING

1920-40 Insurers routinely discriminate against minority clients

1968 Presidential panel on Insurance in Riot-Affected Areas documents impact of redlining for the first time

1980 Aetna admits past racial discrimination with ads showing man eating crow

1988 Amendment to Fair Housing Act of 1968 and new HUD regulations prohibit redlining for homeowners' insurance

1992 American Family Insurance sued for racial discrimination

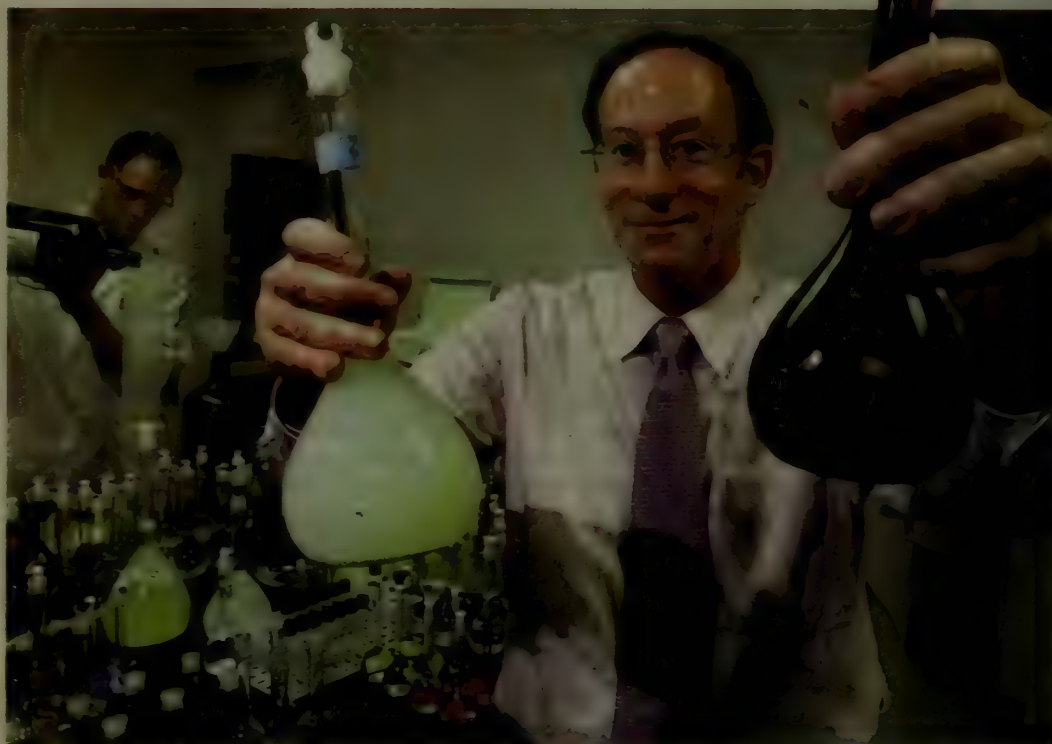
1997 Nationwide Insurance fined \$10 million in Texas for redlining

1999 Use of credit records as insurance-eligibility criteria starts to become widespread

2002 More than 20 states are investigating insurance credit-scoring

and the financially responsible of all some levels, not to discriminate. (GEICO p. wouldn't comment. State Farm ers credit scores to assess whether to are someone, not to set rates.) ere's a powerful correlation between dit history and potential losses from cyholders," says Dean K. Lamb, research director at Allstate, which has id credit scoring for pricing since 9. "What we're trying to measure is how much money a person has but y they manage it."

Allstate and some other insurers say dit scoring lowers some customers' es. Progressive says in a statement t 63% of its U.S. policyholders "have ower rate because of our use of cred- n conjunction with other factors." But ulators in some states, including as, where State Insurance Commis- ner José Montemayor has ordered in- stigations of Allstate and Farmer's Bu- u, think financial criteria could be ind last year's sharp rise—as much as y some estimates—in homeown- and auto insurance premiums na-



ANALYSTS

ANDRX: IS WALL STREET BLINDED BY LOVE?

The drugmaker faces serious competition—and insider selling

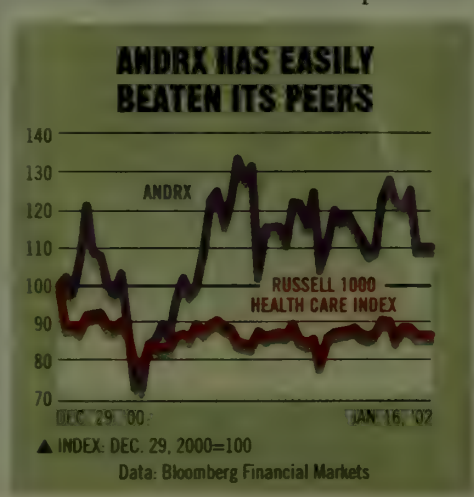
As managing director of Sterling Financial Investment Group Inc., a research boutique in Boca Raton, Fla., Steven C. Kirsch has seen more than his share of dog and pony shows. But when a generic-drugmaker called Andrx Group gave a presentation at a Bear, Stearns & Co. health-care conference a year ago, Kirsch was stunned. "Andrx management got a standing ovation," recalls Kirsch. "In 20 years on Wall Street, I've never seen anything like it."

The applause has not stopped. Andrx' Nasdaq-traded shares gained 22% in 2001 (chart). Though its shares are down this year because of profit worries, its market cap is a beefy \$4 billion because of cheers from a small army of Wall Street analysts. They are most enthused about an undeniable coup: Andrx is the first company to win U.S. Food & Drug Administration approval to make the generic version of the antiulcer medication Prilosec, the world's best-selling prescription drug.

But if a few naysayers, including Sterling and a handful of short-sellers,

are right, Andrx is merely a competent but humdrum company that has been overhyped. They claim that the Street is overlooking or underplaying serious negative factors, including potentially devastating competition and management departures accompanied by heavy insider selling. If the bears prove correct, Andrx shareholders are in for some bitter disappointments.

The tussle over Andrx is a prime ex-



ACTING CEO HAHN

Worries that Andrx' generic version of Prilosec will be hurt by a competing drug are overblown, he says

ample of an old issue that reappeared following Enron Corp.'s downfall: Are brokerage analysts likely to gloss over flaws in the companies they cover? It's a troubling question, and there are few cases where the boundaries are drawn more fiercely than that of Andrx.

Much of the disagreement involves Prilosec. The drug, with \$1 billion in sales in 2000 in the U.S. alone, is manufactured by AstraZeneca PLC, the British pharmaceutical giant. According to buy-side Street analysts, Andrx sales will benefit richly once patent litigation is resolved. They predict that

Andrx stock, now trading at about \$64, will rise as high as \$115 in coming months because of generic Prilosec and other drugs in the pipeline. Analysts also say that generic Prilosec alone will generate \$100 million in sales in its first six months in the market. Among Andrx' champions is Standard & Poor's, which recently named it one of the 35 companies expected to be stellar performers in 2002. (S&P is owned by The McGraw-Hill Companies, publisher of *BusinessWeek*.)

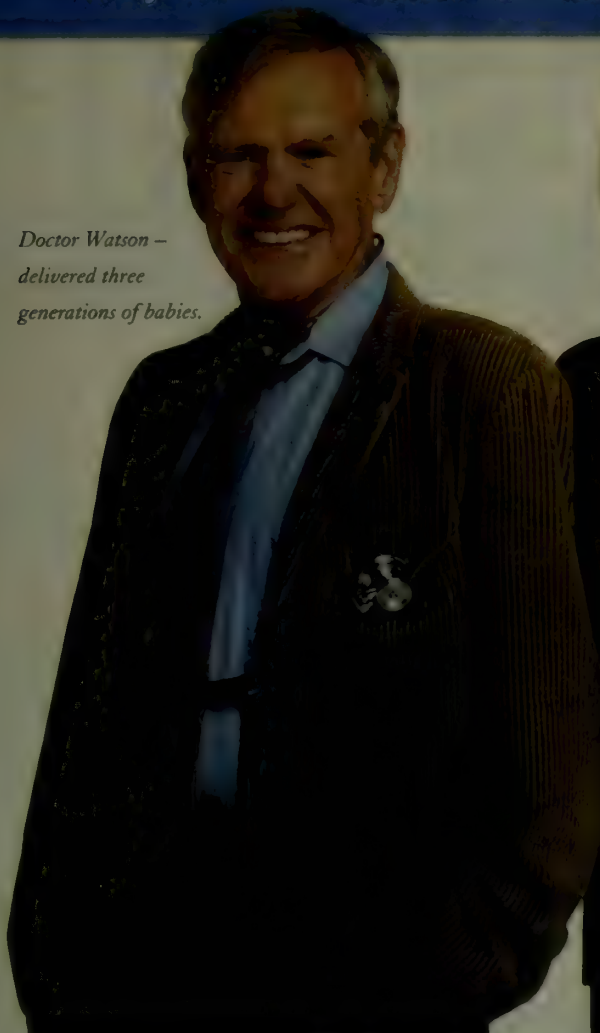
Of the 18 analysts who follow Andrx, a few have qualms about the company, a few have qualms about the stock's valuation. Only Sterling is outright negative and has put a rare "sell" rating on the stock. "The fact is, we get a lot of compliments," says Elmer F. Hahn, Andrx' acting CEO.

Andrx management concedes that bringing their generic version of Prilosec to market won't be easy. For one thing, the company is duking it out over patent issues with AstraZeneca in a lawsuit now under way in U.S. District Court in Manhattan. But even Andrx' critics think it will win the court battle. They're worried about a drug called Nexium, which AstraZeneca is marketing as a replacement for Prilosec. And detractors note that Nexium has already begun to gnaw away at the market share of Prilosec, which AstraZeneca no longer promotes. "AstraZeneca is converting doctors from Prilosec to Nexium and is aiming a big ad campaign at patients," says one short-seller.

That issue is also raised by Robert M. Wasserman, a Sterling analyst who covers Andrx, which is based in Dav-

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Finance

Fla. He is concerned about Nexium and a possible over-the-counter version of Prilosec. "I'm sure that the company will say they'll never go OTC," says Wasserman. "But the other ulcer drugs did just a year or two after they went generic."

Baloney, say Andrx boosters and Hahn. They claim that worries about Nexium and a possible OTC version of Prilosec are overblown and have already been incorporated into their calculations. "Everybody knows Nexium is on the market and gaining share," says Gregory B. Gilbert, who follows Andrx for Merrill Lynch & Co. He does not believe that an OTC version is imminent.

Andrx fans and foes also differ strongly over the departure of the company's two top executives and co-chairmen. Chief Executive Officer Alan P. Cohen left Andrx last year to take over the National Hockey League's Florida Panthers, and Chih-Ming Chen, chief scientific officer, is leaving for what associates call "personal reasons." Cohen and Chen did not return calls to their offices. But in an e-mail to *BusinessWeek* in response to questions, Cohen observed that it is "time for a change." He added that "money doesn't drive me at this point, and my heart

"I'm sure the company will say they'll never go OTC. But the other ulcer drugs did just a year or two after they went generic"

ROBERT WASSERMAN

*Sterling Financial
Investment Group Inc.*

wasn't in it anymore."

Hahn maintains that the departure of the two does not reflect adversely on Andrx' future. He also downplays another factor cited by critics: the recent substantial sales of Andrx stock by Chen and Cohen, including 1 million shares sold by Cohen family partnerships in late October and early November. Cohen's e-mail did not directly comment on his reason for the sales, but it noted that he still owns over \$200 million in stock. "I personally believe in the Andrx employees and their pipeline

of products waiting approval FDA," said Cohen's e-mail.

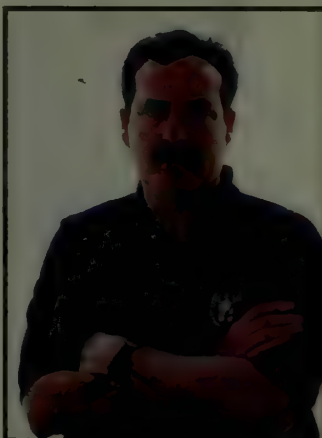
That remains the dominant view of analysts such as UBS Warburg's Valiquette, who has a "strong buy" rating on Andrx stock. He admits to some

about "why they retire ahead of the generic payday in the history of the industry is also worried about stock sell-off. However, Valiquette is not distressed enough about executive departures to lower his rating—on share misgivings with clients. In an April report, he described Chen's impending departure as a neutral event and said that "we

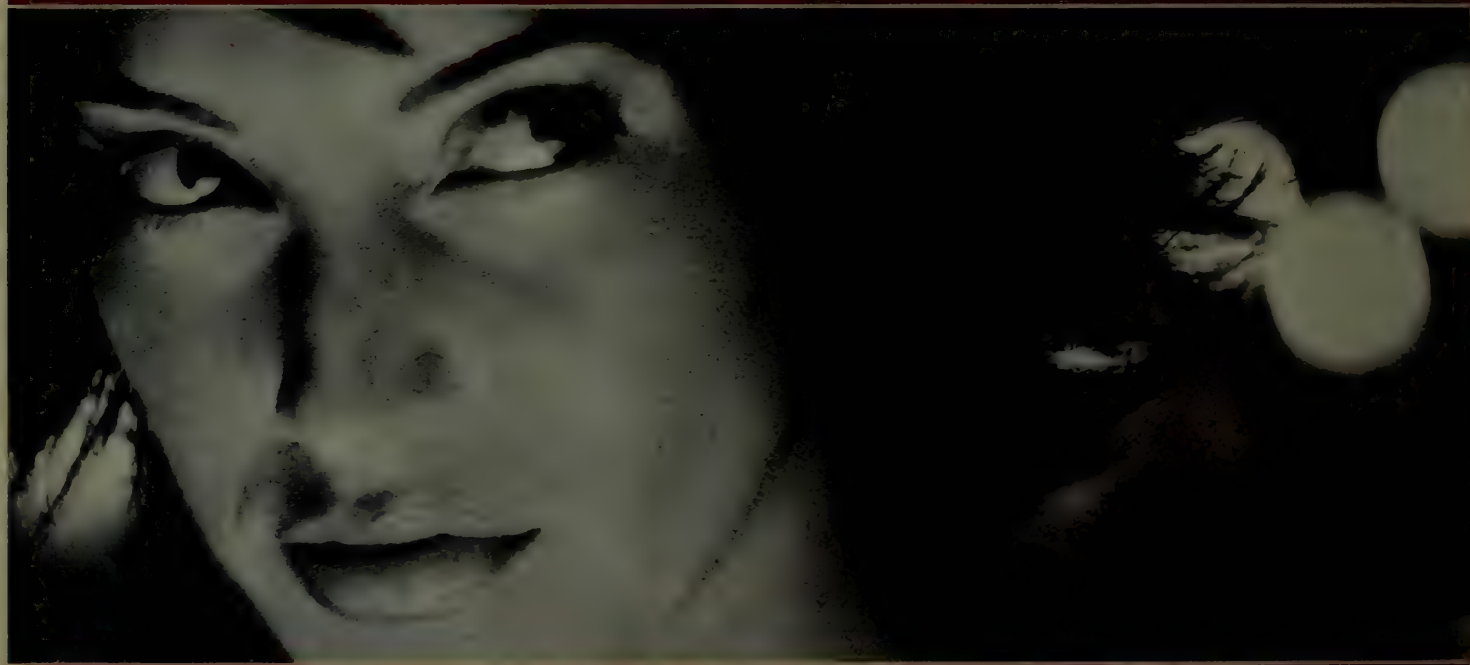
have a higher level of concern" if they were to retire, because of his experience. But when Chen did indeed depart, Valiquette did not repeat his misgivings.

Such optimism is often justified if the bears' predictions come true. Street analysts will have a lot of explaining to do.

By Gary Weiss in New York



DINNER IS NOT THE END OF THE DAY.



IT'S THE BEGINNING OF THE EVENING.

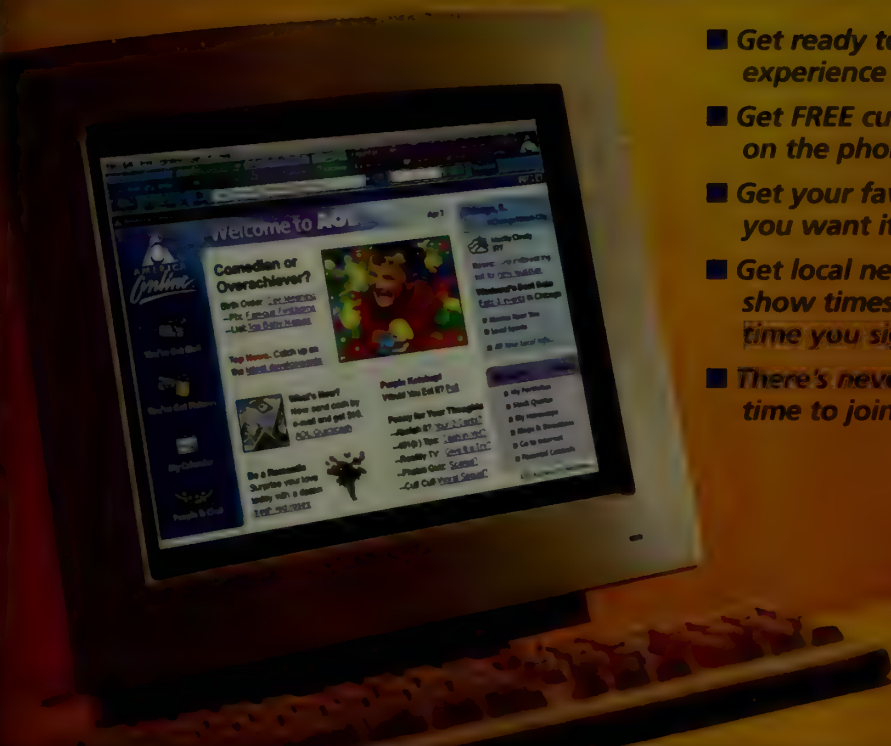
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AUTOS

ATTACK OF THE KILLER CROSSOVERS

New models from Europe and Japan are bruising Detroit

For the thousands of consumers strolling around the Detroit auto show in mid-January, the array of new vehicles and concept cars has been dazzling. The lion's share fall into the category known as "crossover vehicles," hybrids that combine the rugged looks and all-wheel-drive of sport-utility vehicles with the seating capacity of minivans and the smooth ride and handling of sporty sedans. Car buyers ogled Toyota Motor's extra tall Matrix wagon, Chrysler's Pacifica—one part minivan and one part SUV—and Mercedes' sleek GST luxury concept vehicle.

This something-for-everyone trend may be exciting for consumers, but it's bad news for U.S. auto makers. The profit-starved businesses of Ford, DaimlerChrysler's Chrysler Group, and General Motors are about to see much

tougher times, thanks to the splintering of the lucrative truck market, which they have dominated for decades. Drawn by fat truck profits, new competitors from Honda Motor Co. to Kia Motors Co. continue to stream into the field. The number of SUV and crossover models has zoomed to 60 from 37 five years ago, even as Detroit's total share of those segments has slipped three percentage points, to 72%. "We're witnessing the fragmentation of the marketplace," says Robert A. Lutz, GM's product-development chief. "Pretty soon, we'll have as many vehicle categories as we have vehicles."

Not quite. But fragmentation does threaten to rip U.S. auto makers' profits to shreds. To keep up with the competition, all carmakers will have to expand their truck lineups to include

KENTUCKY L

Carmakers such as Toyota that have flexible factories stand to prosper with proliferation of new vehicles

more SUVs and crossovers—a proposition. Opening a new plant takes two to three years at a cost of at least \$500 million. Ford, Chrysler and GM stand to lose the most. They have voted the most resistant to production of high volumes of additional trucks. They have the greatest difficulty switching gears.

Indeed, the era of model

reward the nimble. Companies that most quickly develop innovative autos on a shoestring will be able to sell profitably at lower volumes. Ford Motor Corp. and Volkswagen, for example, could be big winners, since they are skilled at incorporating shared components among different models to save money. Toyota, Honda, and, increasingly, GM have flexible factories that can assemble several different vehicles on the same assembly line at one time, enabling them to switch output as demand shifts. "The key is flexibility, low costs and being fast to market," says GM Executive G. Richard Wagoner Jr.

Those are qualities Detroit is losing. For most of the 1990s, limited competition from foreign auto makers contributed to the Big Three's huge profits. By selling high volumes of a few basic models of pickups, SUVs, minivans, and running factories full time, Detroit raked in a combined \$14 billion from 1997 to 2000, the peak of its profitability. Those models accounted for virtually all their profits in those years.

But in recent years, Mercedes, Toyota and Honda have been building new truck factories, even as BMW and Nissan Motor Co. retooled plants to add pickup and crossover capacity. Already, profits at the Big Three are being squeezed and will continue to shrink as capacity and competition rise. "The going to be a convergence between



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taken over the
phone or fax in 1990:

flat



Sales when orders
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Detroit has made big profits by selling a few basic models of trucks, SUVs, and minivans. Those days may be over

and car profits," in Detroit, warns Standard & Poor's analyst Scott Sprinzen.

Detroit is already behind the pack in crossovers, a category invented by foreign manufacturers. European and Asian auto makers turned their biggest disadvantage—a lack of truck chassis for making SUVs—into an advantage. Toyota rolled out its RAV-4 in the U.S. in late 1995, followed by Honda's CR-V in 1997 and both were instant hits. As car buyers took a liking to their smoother rides and better gas mileage, auto makers have hustled out a wide array of new models. Latest count: 18 crossovers, with collective sales topping 1 million. Eleven of those 18 are foreign nameplates not affiliated with GM, Ford, or DaimlerChrysler, and they've grabbed 57% of crossover sales.

Moreover, domestic brands are losing their one solid chance of winning back business from foreign-brand cars. Chrysler, Ford, and GM won a steady stream of converts from the mid-'80s until recently, as baby boomers in need of space traded their Toyota Camrys and Honda Accords for American-brand minivans and SUVs. Now loyal import owners need never leave their trusted marques.

That scares the daylights out of Detroit executives. Of all the new vehicles at the auto show, the one that worries them most may be the Honda Pilot, a less expensive, eight-seat version of Acura's upscale MDX crossover SUV. Honda's initial plans to build a mere 75,000 Pilots hardly sounds threatening. But that's where Honda's wizardry with flexible manufacturing comes in. Together, the company's two plants in Alliston, Ont., and Lincoln, Ala., can churn out any combination of 300,000 Pilot and MDX SUVs and Odyssey minivans. That allows Honda to concentrate on which-

ever model happens to be in greatest demand.

Such flexibility eludes old-style mass manufacturers like Ford. The No. 2 auto maker is geared to cranking out hundreds of thousands of Tauruses, Explorers, and F-150 pickups, with as many as three factories dedicated to each vehicle. But in a fragmented market, "it's hard for any manufacturer to sell two plants-full of one product—or

body shops is flexible. They are severely limited in their ability to build more than one model on an assembly line. So, for instance, as demand for Taurus drops, auto maker can't put those facilities' employees to work making something more popular, without spending millions and shutting a plant for months.

DaimlerChrysler is in the same boat. Its plants are so inflexible it's unable to expand output of one of its few hits



TOYOTA PRODUCTIVITY
Horning in on the market.
Three's minivan to

PT Cruiser. Although Chrysler designed the Cruiser on the same chassis as the slow-selling Neon subcompact, it can't build more than the popular Cruiser at its Belvidere (Ill.) plant without costly renovations. Instead, Chrysler has slowed Neon production at Belvidere to one shift and may close the plant—while spending some \$400 million to expand Cruiser output in Mexico.

GM is in better shape. Woefully behind other carmakers in the past, the company has been fighting back some years ago. It invested heavily in new technology and equipment to make its truck factories more adaptable and to retool car factories to allow them to make

COSTLY CHALLENGES

The proliferation of "crossover vehicles" is putting new strains on carmakers

SPEEDIER PRODUCT DEVELOPMENT

Carmakers must bring new concepts to market faster to cash in on fickle consumer preferences

MORE FLEXIBLE MANUFACTURING

As markets fragment into niches, plants will have to crank out a variety of models in smaller batches

BETTER ENGINEERING

To cut costs, designers have to increase component sharing among vehicles even as each auto must look distinctive

STRONGER MARKETING

Advertising will have to do a better job of differentiating among similar models so consumers don't get confused

even to sell out one plant," says James J. Padilla, head of Ford North America. When demand for any vehicle drops, Ford is stuck with extra capacity that its union contract won't let it shed.

That's why converting the body shops at as many as one-third of its 21 North American assembly plants is a top priority of Ford's Jan. 11 restructuring plan. Unlike Ford's European operations, which recently retooled three body shops to allow those plants to make two or three completely different models simultaneously, none of Ford's North American

trucks and crossover SUVs. The standard is its brand-new \$560 million Lansing (Mich.) plant that will soon build Cadillac STS and CTS sedans in the same body shop as the SRX crossover sport utility and a Saab.

Pressured by dire necessity, GM moved from worst to first among the Big Three in manufacturing agility. It's a feat that only puts more pressure on Ford and Chrysler, if they are going to hold on to crucial truck profits.

By Kathleen Kerwin and David Welch in Detroit

For some companies, long term planning means an *annual plan*...
...at Omron, we just finished our *decade plan*.

It's called Grand Design 2010. And it's our roadmap for developing and applying our core competencies in *sensing and control* technologies toward the needs of the 21st century society. It's not a crystal ball, but a tool to focus our vision of creating a better tomorrow, today. In manufacturing, healthcare, automotive systems, security and electronic components, Omron is harnessing the power of intelligent information sensing, networks and controls to deliver innovative solutions that offer greater comfort, convenience, safety, productivity and quality and enhance the way we live and work.

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Jack Welch's successor charts a course for GE in the 21st century

After winning the highest-prized succession race in corporate history, filling Jack Welch's seat as CEO and chairman of General Electric Co., Jeffrey R. Immelt now finds himself charged with delivering double-digit growth amid war and a nasty downturn. BusinessWeek Editor-in-Chief Stephen B. Shepard spoke with Immelt on Jan. 15 as part of the magazine's Captains of Industry series at Manhattan's 92nd Street Y. Here are excerpts from their conversation:

It's fascinating to me that your father worked 38 years for GE and then you ended up running the joint. When you told your father, what did he say?

It was the first call I made and one of those moments I'll always remember. He said how proud he was. He said congratulations. And he said, "Now you can do something about the pension."

What would have happened if you hadn't gotten the job?

In about September of 2000, Jack told all three of us that if we didn't get the job, he wanted us to leave. I knew I could find a job somewhere. Probably, at the end of the day, I would have gone to 3M, where Jim McNerney ended up. The three of us got embroiled in something that was cast as the race of the century. But we've remained good friends because we respect one another.

I'm told you work seven days a week and sleep five hours a night.

I think about the company all the time, and I don't need much sleep.

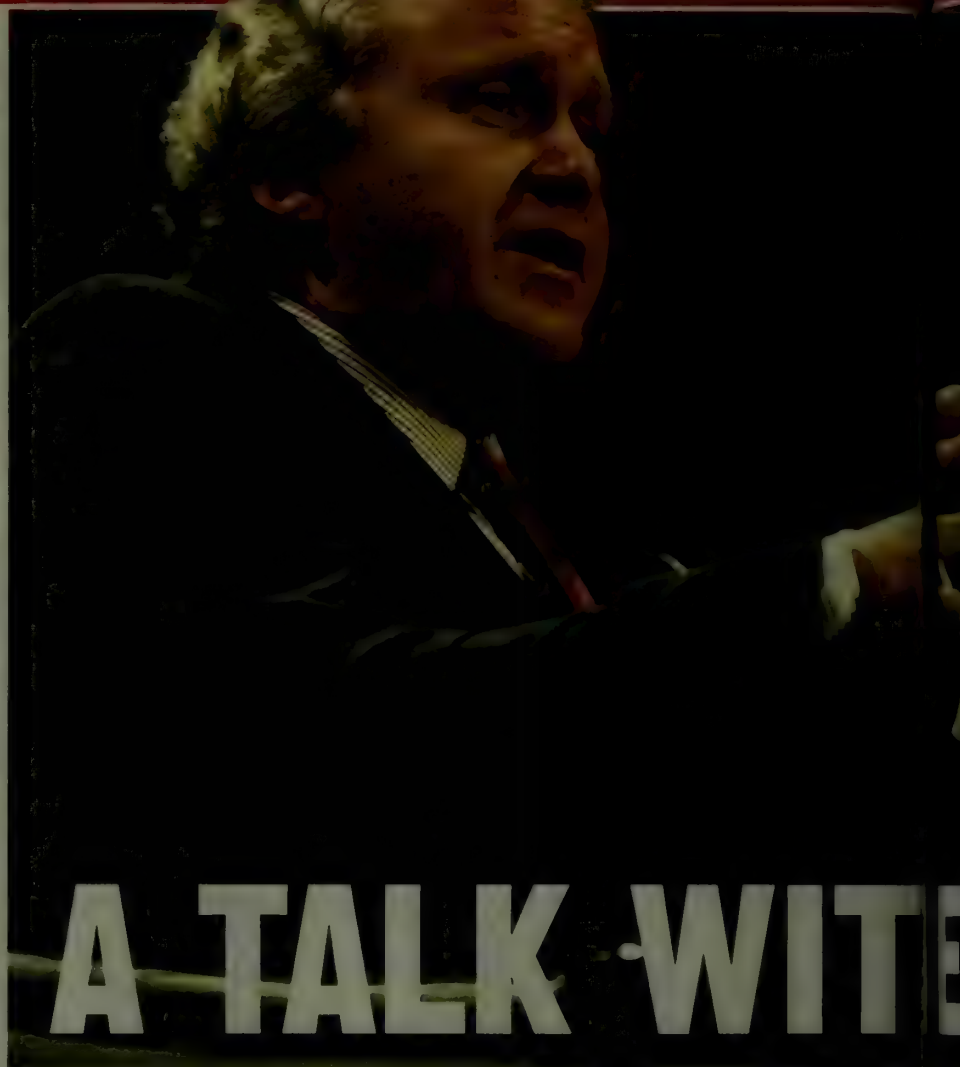
It's also true that you read a book a week?

Just about. Yeah.

What kind do you read?

I do a lot of biographies, a fair amount of history, and some novels. I don't read many business books. I just read the [Edmund Morris] book on Theodore Roosevelt.

You and George Bush.



I wasn't eating pretzels at the time, though, so it's a little safer.

What CEOs in America do you admire or respect?

I've had a long-term relationship with Steve Ballmer [at Microsoft Corp.]. I think [Vivendi Universal's] Jean-Marie Messier is building a heck of a company in that business. Rick Wagoner is doing a good job at GM. There's [Sun Microsystems Inc.'s] Scott McNealy, who is on our board. I've always admired Scott's sense of humor, his vision, his ability to stick with a vision. Globally, I have a lot of respect for John Browne at BP and for [Nobuyuki] Idei-san at Sony.

What do you want to accomplish in your first few years?

I want to take the power of digitization and, like we've done with Six Sigma, transform the way the company is run. About 40% of the company is now administration, finance, and backroom functions. Over the next three years, I want to shrink that by 75%. On top of that, the most important thing is to

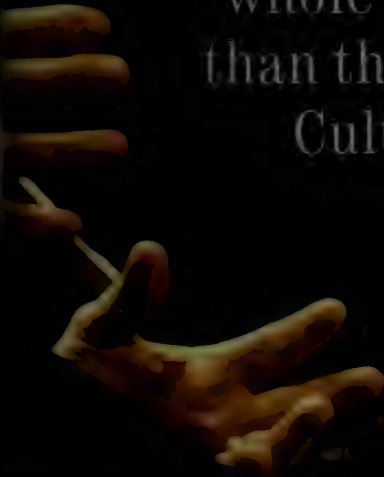
grow. We're a \$130 billion growth business because we don't run it as a \$100 billion blob. We run it as a \$10 billion medical business, a \$1 billion ultrasound business. We know how to get double-digit growth in this environment.

How did September 11 make the more difficult for the company and you personally?

Let's categorize September 11 as an amazing tragedy, just an unbelievable unspeakable tragedy. It had an impact on the airline industry and the tourism industry and the insurance industry. But this economy was in recession before Sept. 10. This economy started getting worse in August of 2000. It was accelerating in terms of getting in a recessionary mode. And September 11 made it tougher.

I look at this environment as a tremendous chance to play offense for GE. The strength of GE is our diversification. So while 30% of our company gets hit in an economy like this, 70% is flourishing. We'll generate \$17 billion in cash in 2001, so we'll have lots of capability to do acquisitions. You know where my stock price is today?





“We run a multibusiness company with common cultures, with common management...where the whole is always greater than the sum of its parts. Culture counts.”

JEFF IMMELT

I love where everybody else's is. It's a great time to do acquisitions and play offense. We're looking at this time as the defensive time for GE. Quite honestly, it's tougher to run the company in recession. We were growing. The markets were great; the equity markets were hot. But everybody hated a 120-year-old company. You know, anything that's not new was terrible. Now we look at it again.

You object when people use the word conglomerate to describe GE?

I hate it. I went to business school and they're teaching how companies like GE couldn't do it. We run a multibusiness company with common cultures, with common management...where the whole is always greater than the sum of its parts. Culture counts.

Where any company anywhere in the world that is remotely close to the way you do it?

My assumption is yes. I view Siemens as a very strong competitor, from Germany. I think Dennis Kozlowski at Tyco is attempting to do the same thing. So

we never take for granted that we've got the only model that works and that there aren't people out there trying to compete with us. I just think that we've got a company that can run in this way.

GE Capital accounts for 40% to 45% of your earnings. Do you think that's too high?

My preference would be to keep it in that range. But I hedge that it's an exceptionally good time to be acquiring financial assets today. If we have the opportunity to make GE Capital bigger in the short term, we'll probably take that opportunity.

What about the lower-margin businesses, like lighting and appliances? What happens to them?

If we were building a portfolio today, we wouldn't start with lighting and appliances, that is for sure. We're limited by the growth, and we're limited by the positions they have in terms of being able to globalize and things like that. Neither business is on fire. We're No. 1 in both. They both return their cost in capital. They're good for the brand.

And the way that we use a business

like appliances is, it's a great place to train people. It's a great way for managers to go there and learn what a recession is like. Because those businesses are in recession almost all the time. Even the good years are tough. So you learn unbelievable management skills at businesses like that.

Let's talk about globalization, one of your big initiatives. I'm going to name countries, and I want you to tell me what you think the opportunities are. Let's start with Japan.

Very bleak. Most of the global companies are moving manufacturing facilities outside of Japan. My fear is that it's in a permanent state of sideways movement. You'd almost rather see an impetus of a sharp decline that would drive structural change. Unfortunately, what we have is constant zero. I think it's demoralizing to the people in Japan.

China?

China is going to be the second-biggest economy in the world. The political leadership of the country really does understand the people. I'm not here to make a political statement. None of us

HOT SEAT: *In conversation with Editor Shepard*

agrees with everything they do, but I think there's an inextricable movement to the future. There's just no stopping that country.

India?

India is a great place. They graduate 30,000 electrical engineers every year. From the standpoint of human capital and from the standpoint of education and smart people, they are fabulous. The infrastructure of India keeps it from being a great global market. The power still goes out when you're shaving every morning at 6. But it has probably got the best intellectual depth in the world.

Europe?

I really do believe that the European Union and European unity is going to change the way Europe does business. Having one currency, having one market is going to be a good deal. Our margin rates are half what they are in the U.S., so there are great opportunities to improve.

Beyond that, I hate the way the Honeywell acquisition ended in Europe. And I hate the way it cast our company. So Europe is very big on my agenda list. We got painted with a brush that was unfair: of being too big, of not being focused on customers in the

Management

marketplace. I'm really dedicated to proving that wrong. We're going to be a great European country—I mean company.

So you do have some politician in you. Latin America?

NAFTA really did work from both a Mexican and U.S. standpoint. But south America is very tough. It's never been a place where GE invested a lot because of currency instability and a lack of transparency. Unfortunately, Argentina only serves to reinforce that.

Let's turn to Enron. It's a mess. What are the lessons of this?

Either people in leadership misled folks, or there's something wrong with the system, and the system has to be

for each and every day is the integrity of the company I work for.

When do you think the recession will end, or when will we have a turnaround?

The two factors I watch, Steve, are what's happening with the consumer and when will technology reinvestment occur. There is massive excess capacity in technology today. And I think when you add all those things up, we're doing all our business planning assuming that 2002 stays as tough as it is right now. A zero-growth economy. If we get a second-half rebound, all the better. By 2003, we see the economy getting better.

Just about two years ago, Jack Welch



has to do with remaining a modern company. And 21st century companies are going to have more diversity throughout their leadership.

So there was nothing about the company's culture that made it more difficult for women?

This is a performance culture. I just refuse to believe that there's anything about the culture that makes it unattractive for anybody to work. It's meritocracy. People like meritocracy. They like being treated fairly. They like knowing that they get paid based on the merits of their ideas. I don't think that's sex-based.

What keeps you up at night?

It's always a integrity issue of some kind. With 300,000 people, you always worry that someone doesn't get it. You can survive bad mistakes. What you live through is somebody who takes the company or something wrong with the community.

At a recent *Business Week* event, Welch said that V. P. Hewlett's opposition to the Compaq/Hewlett-Packard merger was "a sin." What are your thoughts on Wal-

standoff with the Hewlett-Packard board?

I am firmly on [HP CEO Carleton Fiorina's] side with respect to her wanting to do it, the process she used to do it, and the fact that a board can't vote that way. There's a time and a place for a board to make a decision and make its feelings known. To be in the ranks and to come out and question publicly is wrong.

Do you send handwritten memos to your top staff, similar to Jack's memo to you?

No, my handwriting is terrible. I never had the luxury of not only running a company but he had the best penmanship. I send e-mails.



“About 40% of the company is now administration, finance, and backroom functions. Over the next three years, I want to shrink that by 75%”

changed. That's what we're going to learn over the next few months.

Two years ago, every business leader on earth got the benefit of the doubt. Because of the recession, because of Enron, that trust has evaporated. So it's incumbent on me not just to describe my company. I now tell people, look, I review every business in GE six times a year. I have 500 internal auditors; we do thousands of audits every year. We all have one currency at GE—that's GE stock. We're totally aligned with shareholders. I don't want my company to be painted with that brush.

But you worry a little bit that there might be a backlash?

The backlash is beginning. When the seventh-largest company in the world goes bankrupt in six months, something happened. Something happened that's wrong, and that's bad. But one of the things that I'm going to stand up

was here on this stage. We asked him why there were so few women in the top management ranks at GE. And his answer was, "Shame on us." What is it about GE that there aren't more women in the top ranks, and are you going to do anything about it?

You know, Steve, if you look at the last 12 months, 50% of our appointees of the top 500 people are women and African Americans. So we're moving the needle very quickly. About 20% of the leadership today is diverse. We've got a great pipeline of women in place to be able to fill those jobs. I think it's a leadership prerogative, and it's a leadership objective, to be a more diverse company.

I've told people that one of the things that I'm going to be accountable to the organization in is the percentage of women and African Americans that are in the top 175 in the company and the top 500 in the company. Again, it all

BusinessWeek online

For a video of the entire interview go to the Jan. 28 issue online at www.businessweek.com.

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STRATEGIES

KMART: THE FLOOD WATERS ARE RISING

Conaway's rescue plan looks shaky amid bankruptcy talk

Can Kmart Corp. avoid bankruptcy? The country's second-largest retailing chain has been scrambling to extend financing that will enable it to survive after a disastrous year culminating in an abysmal holiday season. Viewing Kmart's estimated \$400 million in cash and \$3.8 billion in total debt, many investors now wonder whether the Troy (Mich.) company's cash flow is strong enough to allow it to stay afloat, let alone implement an ambitious restructuring plan under CEO Charles C. Conaway.

The latest wave of dread began on Jan. 10, when Kmart issued a profit warning and said it was reviewing its business plan and liquidity issues. Major credit agencies slashed Kmart's already low credit rating further, sending it deeper into junk territory. Some worried vendors also began withholding merchandise shipments or demanding immediate payment. Investors, meanwhile, are stampeding toward the exits. Since Jan. 1, Kmart's battered shares have fallen 71%, to just \$1.60.

Conaway is now racing the clock, trying to renew and expand \$1.5 billion in bank credit by putting up billions of dollars in inventory as collateral. Yet amid swirling rumors that Kmart is on the brink of bankruptcy, company management has remained virtually silent about the extent of its financial problems and its strategy for getting out of the mess. "Things have gone into free fall faster than we thought," is all one high-ranking official will say. But that silence has sapped confidence even further.

Industry insiders agree that if the company is going to save itself, it must radically alter its turnaround strategy. Instead of attacking main competitor Wal-Mart Stores Inc. head-on, Kmart must carve out a less competitive niche for itself. And, they say, the retailer must quickly shutter underperform-



BAD DECISIONS: Conaway's price reductions were topped by Wal-Mart

ing stores. "It's a nail biter," says Sanford Bernstein analyst Emme Kozloff.

Although he put in a successful stint as a president of cvs Corp. before joining Kmart in June, 2000, Conaway has had trouble making headway at the retailer. Early moves to improve inventory control and customer service proved smart, but Conaway also has made costly mistakes. His initial strategy was to get more shoppers into stores by lowering prices to match Wal-Mart on more than 30,000 basic items such as toothpaste and diapers. The move backfired when Wal-Mart responded by dropping its own prices even further. Meanwhile, Conaway cut the size of Kmart's advertising inserts in Sunday newspapers: He viewed them as costly and inefficient. But with advertising down, Kmart attracted even fewer shoppers as the economy worsened.

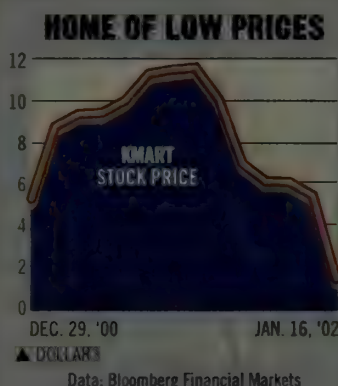
The sorry result: In the quarter ended Oct. 31, Kmart lost \$224 million, as sales fell 2.2%. Worse, in the crucial December month, its sales fell 1% as Wal-Mart's surged 8% and Target's rose 0.6%.

How can Conaway reverse Kmart's slide?

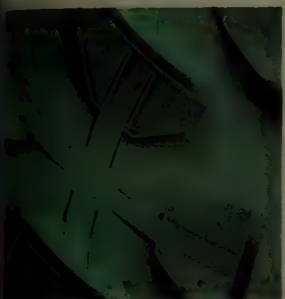
One no-brainer: He could dump underperforming stores instead of trying to fix them. Kmart has identified a group of 250 performing outlets. While some estimate closing them would cost about \$1 billion, it would let the company direct resources toward more promising urban store locations to cater to Latino and African American consumers. That move will take time, but the company also plans to quadruple its efforts to promote private-label brands Martha Stewart Everyday, Sesame Street, and Route 66. Martha Stewart sales alone rose 25% last year, to \$1.5 billion. And a new seven-year contract that provides increased royalties and minimum guarantees, Stewart's company is solidly behind Conaway's turnaround effort. "You have to credit him with taming the monster," says Sharon Patton, president of Martha Stewart Living Omnimedia Inc.

Will Conaway and Kmart have time to implement new plans before the monster runs out? "The silence is working against them," says Robert Goch, a fixed-income analyst at Miller Tabak Roberts Securities LLC in New York. Unless executives are showing publicly that Kmart can mount its financial hurdles, all the good ideas in the world aren't likely to get much help.

By Joann Muller in Detroit



ED BY ELLEN LICKING



AY TO GUIDE Y SATELLITES O PORT

NEERS HAVE DREAMT OF flying swarms of picosatellites—spacecraft the size of hummingbirds—to maintain, repair, and gather data from larger satellites and space stations. But for that to happen, the tiny birds would have to be able to dock frequently to refuel and offload data their sensors collect. A new pulsating artificial satellite developed at Stanford University and adapted by Peter Böhringer, an electrical engineer at the University of Nottingham, may facilitate this. Designed to behave like the small hairs that line the human windpipe, these so-called microcilia wave back and forth to nudge the picosatellite in different directions. The microcilia are made of a polymer that has been deposited onto a silicon wafer. Each hair comes equipped with a heating element made of iridium and tungsten that controls its movements. When cool, a cilium curves away from the silicon wafer. But when heated, it extends out. By precisely regulating the temperature of each hair, it is possible to coordinate the waves necessary to move small objects. In gravity laboratory tests, Böhringer says, a patch of microcilia was able to move a 10-milligram block across the surface of an air-hockey table. The results were recently published in *Smart Materials & Structures*.

ANOTHER STEP CLOSER TO AN AIDS VACCINE

SCIENTISTS ONCE HOPED THAT HIV could be tamed by stimulating the immune system to make antibodies that neutralize the invaders. But while antibodies can protect against measles or polio, none has proved potent enough to fight AIDS. So researchers have been trying to harness another part of the immune system: killer T-cells.

This approach is showing promise. In the Jan. 17 issue of *Nature*, scientists at Merck and at Duke and Harvard

universities report that an experimental vaccine enables monkeys to keep the virus at bay for more than a year—although the vaccine doesn't prevent infection. It uses a modified cold virus to carry an HIV-like gene into the body's cells. The cells use the gene's instructions to make a viral protein, which they display on their surfaces. Then the immune system makes killer cells to attack any cells displaying the protein. But even this may not be sufficient. Another report in *Nature* suggests that the virus, in some cases, can mutate drastically enough to escape the attacks. *John Carey*

INNOVATIONS

■ Medical researchers at the University of California at Irvine believe that attention-deficit hyperactivity disorder (ADHD) may result from a genetic mutation that helped humans adapt to their environment thousands of years ago. The scientists studied the genes of 600 people and found a new variation in the dopamine receptor gene that is linked to both ADHD and a behavior trait correlated with greater alertness called "novelty seeking." The variation appears to have arisen between 10,000 and 40,000 years ago—at what is thought to have been the dawn of human societies.

■ A technique that dramatically reduces the amount of liquid emitted by inkjet printer nozzles has been developed by chemists at Purdue University. It could lead to printers that produce higher-resolution images while using less ink. Scientists have spent years trying to reduce droplet size by building smaller and smaller nozzles. The Purdue researchers decided instead to alter the electrical signals that control how the nozzles produce the droplets. The result: droplets 1/10 to 1/20 the size of those from commercially available nozzles.

■ Brookhaven National Laboratory scientists may have found a way to curb the pollution from burning coal. Mow Lin and Eugene Premuzic harvested naturally occurring bacteria called *Leptospirillum ferrooxidans* from piles of coal refuse and grew them under harsh conditions. The bacteria that survived were able to gobble up the sulfur, heavy metals, and other toxic impurities that give coal its dirty reputation. Power plants typically wash coal to remove contaminants before burning it. Lin believes that *Leptospirillum* could be added to the washing mix to improve the cleaning process.

THIS SPERMICIDE MAY ZAP VIRUSES, TOO



A NOVEL CONTRACEPTIVE GEL THAT MAY ALSO PROTECT against sexually transmitted diseases and urinary tract infections is under development at Johns Hopkins University and privately held Baltimore-based ReProtect. In the coming months, almost 1,000 women will participate in a clinical trial using this new contraceptive, called BufferGel. Next year, the scientists plan to launch an even larger trial to test BufferGel's ability to block transmission of HIV and genital herpes.

Conventional spermicides such as nonoxynol-9 are made from detergents that kill sperm by stripping away their outer membranes. Although effective, these soap-based spermicides can irritate the vaginal lining and also wipe out "good" bacteria that thwart bugs responsible for urinary infections. BufferGel works by a different mechanism: The colorless polymer that forms the basis of the spermicide reinforces the mildly acidic conditions of the vagina that are toxic to sperm and other microbes. And because the polymer has been used in other pharmaceutical products for many years without problems, the compound is believed to be very safe. ■

COMMENTARY

By Peter Coy

DEREGULATION: INNOVATION VS. STABILITY

The year 2001 was awful for three important American industries.

Electric utilities suffered capacity shortages that led to price spikes and scattered blackouts. Airlines, even before September 11, had to cancel flights and put planes into desert storage. And the overbuilt telecom-services sector cut investment so dramatically that it helped drag the entire U.S. economy into recession.

What 2001 demonstrated is what many economists have long argued—that certain industries are inherently unstable. Utilities, airlines, and phone companies all have the same Achilles' heel: Nearly all their costs are up front. Once they build capacity, they can increase their output at little cost. This may sound like a recipe for making money, but it's really a recipe for a big mess. Industries whose costs keep falling as production rises tend to turn into monopolies or oligopolies. Their pricing is byzantine. Captive customers (like business flyers) pay far more than noncaptive (like tourists). And investment tends to swing wildly between boom and bust.

Regulation can tame these instabilities, but it also suppresses innovation and takes away incentives for companies to be efficient. So for the past two decades, government has been deregulating so-called increasing-returns industries—to the delight of some and the horror of others.

What have we learned in recent years? In a nutshell, deregulation of increasing-returns industries has been less than a complete success. On the positive side, deregulation has increased efficiency and innovation. Airlines have reduced costs by concentrating operations in hubs. Upstart independent power generators have built gas-fired "peaker" plants that start up when prices rise. In telecom, cell phones have shrunk to palm-size and let their owners cruise the wireless Web for weather, traffic, and market updates.

But deregulation has also brought about concentration of ownership, enormous pricing disparities, and violent gyrations of investment. What's more, these problems are not easily avoidable.

They may, in fact, be the price society pays for efficiency and innovation. The Brookings Institution's Robert W. Crandall, a leading advocate of deregulation, acknowledges that booms and busts of investment, in particular, are "just endemic in capitalist markets."

Think about why increasing-returns businesses are unstable. It costs a lot of money for them to gear up, but once they do, each incremental unit of output is extremely cheap to produce. Take airlines. Once they fill their planes enough to cover their fixed costs, each additional passenger is enormously profitable. Trouble is, those profits invariably entice new entrants. Capacity increases. Fare wars begin. In desperation, airlines cut fares until some passengers are paying barely

have risen. The airfare component of the consumer price index has risen 130% from its 1982-84 base, compared to a 77% increase for the CPI as a whole.

Electric utilities are another point. In the past several years, states have deregulated the electricity generation (though not delivery, which remains a monopoly service), hoping that competition would lead to greater efficiency and lower prices. That may eventually be the case, but the transition is ugly. In areas with capacity shortages, spot prices have occasionally spiked to hundreds of times the average rate. California has had rolling blackouts two summers in a

So-called increasing-returns businesses, such as airlines, having incurred costs up front, can hike output cheaply. Money machines? Not quite

more than the cost of their meals. No longer earning enough to cover their fixed costs, airlines must merge or go bankrupt. Capacity falls, fares rise, profits increase, and the cycle begins again.

The turmoil can be considerable. Barely more than a third of the 292 U.S. airlines with scheduled passenger service that were operating when deregulation began in 1978 or began service afterward were still operating independently by 2000. Deregulation advocates like Brookings' Clifford Winston argue that the turbulence is justified by savings on air fares, which he calculates are substantial in comparison with what fares would have been if regulation had remained in place. It's hard to know what fares would have been under regulation. But the fact is that air fares have not fallen, despite the availability of some highly publicized bargains. According to the Bureau of Labor Statistics, in fact, overall prices

row. Lured by the high spot rates, independent power producers have gone on a crash building spree in the Golden State. As a result, a glut is developing. It's a classic case exam-

plains booms and busts that increasing-returns industries experience. Eugene Fama, a consulting economist in Vallejo, Calif., guesses that the answer is public utility regulation of the electricity business—something that's already a fact of life for much of the Tennessee Valley Authority's territory and many sundry municipal utilities across the country. The increased receptivity to that extreme solution is a measure of just how bad things have gotten.

Perhaps no deregulated industry has shown more signs of increasing-returns than telecommunications—in long-haul transmission over fi-

The cables are expensive to poles and lay in trenches, but re in place, it costs hardly to carry traffic over them. As es, fiber carriers are tempted ices to capture customers—to hat revenues fall below ded to pay the interest on . Last year, 28 publicly trad- companies, each with more million of liabilities, sought from creditors in bankruptcy orts BankruptcyData.com. an old problem, to be sure. rian, dean of the School of In- Management & Systems at sity of California at Berke- hat more miles track were 1880s than in

any decade before or since. And more miles of track were in the hands of companies in bankruptcy in the 1890s than at any other time.

Why do companies persistently over-build in increasing-returns industries?

managers can overinvest. "It's worse if you add to that the fact that businesses are not rational organisms but bureaucratic cultures where people come before the managing committee and ask for stuff," says J. Bradford

PRACTICE WON'T MAKE PERFECT

Here's what can go wrong in industries with increasing returns to scale, such as telecom, airlines, and utilities

WINNER-TAKE-ALL

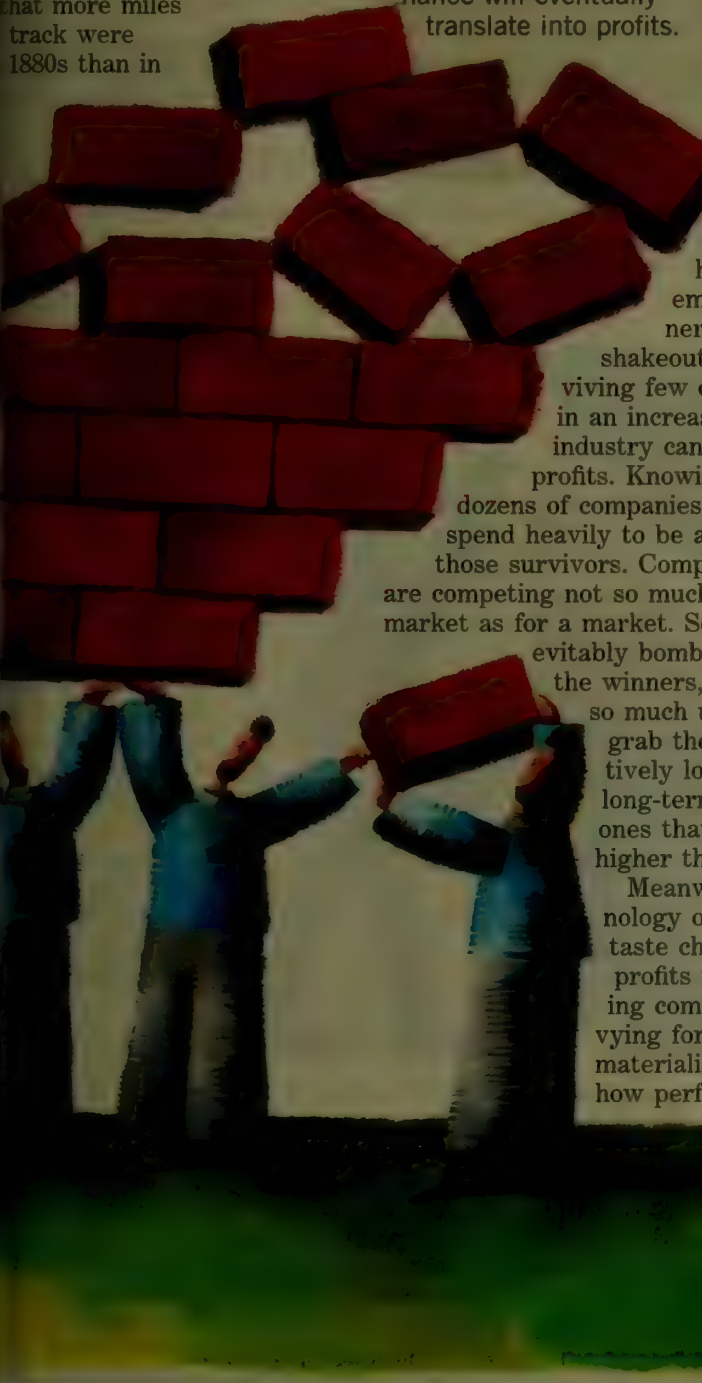
INVESTING In the boom phase, businesses race each other to build capacity, hoping dominance will eventually translate into profits.

MARKET-SHARE WARS

In the transitional phase, prices begin to fall as companies seek higher sales volumes. It's tempting to cut prices because the cost of producing additional units is very low. But prices become too low to cover huge fixed costs.

BANKRUPTCIES

In the bust phase, bankers and shareholders pull the plug on companies that can't make money. Even well-run, promising businesses can't get funded. Capacity falls to the point where prices rise. The cycle is ready to repeat itself.



Often, they are hoping to emerge as winners after the shakeout. The surviving few competitors in an increasing-returns industry can make cozy profits. Knowing that, dozens of companies will spend heavily to be among those survivors. Companies are competing not so much in a market as for a market. Some inevitably bomb out. Even the winners, by spending so much up front to grab the prize, effectively lower their long-term returns to ones that are no higher than average.

Meanwhile, if technology or consumer taste changes, the profits these surviving companies are vying for may never materialize. That's how perfectly rational

DeLong, a Berkeley economist.

There are ways to quell the turmoil, at least a bit. Even in businesses with increasing returns to scale, small rivals can carve out a niche that protects them from a price-slashing giant. That's happening even in the selling of electricity—the ultimate generic commodity—where some companies are marketing their power as green.

The passage of time should help somewhat, too. Telecom and electricity were deregulated recently enough that companies are still thrashing around for a strategy. Many overexpanded by misjudging the demand for new services. Brookings' Winston argues that even airlines are at last figuring out how to get capacity right. He says they would have come through the recession all right if it hadn't been for September 11.

Still, increasing-returns businesses will never be quiet and well-behaved—their cost structures simply won't allow it. And the race for technological supremacy keeps things roiling as well. Crandall, the dereg advocate, acknowledges that regulation would smooth out booms and busts, but at the cost of slowing advances in the state of the art. "One thing that regulation is very good at doing is suppressing technological progress," he says. Take your pick: stability or speed. In increasing-returns businesses, you can't have it both ways.

Coy is Economics Editor.

The Ins and Outs Of the New Tax Law

In 2002, many of the most important changes go into effect

Forget the Beltway bickering about whether the tax cuts passed in 2001 should be delayed. They're here to stay—and that's to your benefit. The rebate checks last summer were just a taste: 2002 is when most of the new law's key changes take hold.

That's why it's vital for you to pay even more attention than usual to taxes this year. The centerpiece of President George W. Bush's tax plan—a phased-in reduction in tax rates—has already fattening your paychecks. But some of the biggest rewards will come to those who act now to use new incentives for retirement plans and college savings. Here's a guide to what's new in the tax code for 2002.

YOUR TAX

The Golden Years Get More Golden

BY CAROL MARIE
CROPPER

With employers retreating from guaranteed pensions and Social Security in flux, Congress decided to use the 2001 tax package to nudge workers to save for their own retirement. The message: You're mostly on your own, so start saving.

The lure for savers is higher contribution ceilings on retirement accounts, along with special catch-up provisions for those 50 and older. The law also cajoles people to put cash into such plans by making it easier to borrow from them or to move assets to a new plan when leaving a job—something Americans are prone to do.

Both Roth IRAs, which are funded with aftertax dollars but allow tax-free withdrawals, and traditional IRAs get higher contribution limits for 2002. You can now stash up to \$3,000 (\$3,500 for the 50-and-up crowd). By 2008, that ceiling rises to \$5,000



(\$6,000 for older savers). Meanwhile, the new cap for getting a deduction on contributions to traditional IRAs rises to \$100,000 for those 50 and older in 2007, vs. \$70,000 in 2002. No cap if you don't have a retirement plan at work, and the caps are doubled for spouses who don't have a plan.

You also can save more through company-sponsored plans, such as 401(k)s and the new 408(a)s at nonprofits and educational institutions. You can contribute a total of \$11,000 this year, up from \$10,500 in 2001. (Those 50 and older can kick in \$1,000 more. That rises to \$1,500

(\$20,000 for the 50-plus group) in 2006. Those used for government workers share similar benefits. Meanwhile, contribution limits for Simplified Employee Pension (SEP) and 401(k)s at small companies rise from \$7,000 this year, then to \$10,000 in 2003 and 2004.

The tax package didn't forget the self-employed. Those with a SEP (Simplified Employee Pension) or a profit-sharing Keogh plan should be able to deduct up to \$40,000 pretax. A glitch in a part of the law limits the deduction to

ve, Save,

ve

le Sam is letting squirrel away re in retirement counts, raising contribution limits this year. 50 by yearend you get an ed boost from cial catch-up visions.

st \$200,000 in self-employment income, or 00, but Congress is expected to correct that. hose with a defined-benefit Keogh, the max- h annual payout rises from \$140,000 to 000.

change designed to make saving more palat- lets the self-employed borrow from their hs now. The law also extends borrowing eges at company-run 401(k)s to those at the uch as sole proprietors.

other shift makes retirement savings more ble, letting workers roll money between e, 403(b)s, and governmental 457s. That's ally good news for those with a 457. Before, ouldn't even transfer savings into an IRA hey left a job. (It's still up to the employer ept funds rolled from another company plan.) u can now also roll regular deductible IRA gs into a 401(k). You forfeit some control, onsolidate your assets. Beginning in 2003, oyers can help workers set up IRAs at the lace. Better yet, in 2006 employers may be o offer Roth-style 401(k)s or 403(b)s. Em- es can then split contributions between a ar 401(k) and one similar to a Roth.

ll of these provisions combine to encourage otivate people" to save for retirement, says lott, publisher of *Ed Slott's IRA Advisor* etter. If your company no longer wants to esponsibility for your golden years, Con- at least has made it easier for you to add to luster.

Saving for College Will Yield Smarter Returns

JANNE TERGESEN

aving for college has never been more at- ractive, thanks to an array of education- elated tax breaks that kicked in on Jan. 1. They include more generous limits on con- tions and donors' incomes, greater deduc- es, and fewer restrictions on the number of u you can tap. The trick is to find the bene- at fit your income level and mix and match for the greatest savings.

	IRA/ROTH IRA		401(k), 403(b), 457	
	UNDER 50 YEARS OLD	50 AND ABOVE	UNDER 50	50 AND ABOVE
2001	\$2,000	\$2,000	\$10,500*	\$10,500*
2002	3,000	3,500	11,000	12,000
2003	3,000	3,500	12,000	14,000
2004	3,000	3,500	13,000	16,000
2005	4,000	4,500	14,000	18,000
2006	4,000	5,000	15,000	20,000
2007	4,000	5,000	**	**
2008	5,000	6,000	**	**

* \$8,500 for 457 **Indexed for inflation, rising in \$500 increments.

Data: BusinessWeek

can switch investment options within the same plan once a year, says Joseph Hurley, founder of savingforcollege.com, which reports on 529 plans. To do so in the past, you had to roll over the account into a different state plan or change beneficiaries. If your child drops out, the list of kin to whom you can transfer the account now includes first cousins of the initial beneficiary. That's an important benefit for grandparents who establish accounts, says Judy Miller, principal at College Solutions, an Alameda (Calif.) financial consulting firm.

The Education IRA, renamed the Coverdell Education Savings Account after the late Senator Paul Coverdell (R-Ga.), has also been enhanced. Each child can receive a total of \$2,000 a year—up from a measly \$500—in these accounts, which grow tax-free and can be invested in any vehicle you choose. Unlike 529 plans, Coverdells can now be used for elementary and secondary school costs, including books, tuition, and tutoring. And more families can set up Coverdells, thanks to higher income limits. A married couple can contribute the full \$2,000 if its adjusted gross income, or income before itemized deductions, is \$190,000 or less, up from \$160,000 in 2001 (table). If you choose to, you can now fund an Education IRA and a 529 in the same year. In the past, those who did so paid a 6% excise tax on the Education IRA contribution, says Andrew Gibson, a partner at accountants BDO Seidman in Atlanta.

The beneficial tax changes extend to those repaying student loans. The income ceiling on claiming at least some of the \$2,500 deduction for interest payments is \$130,000, if married, and \$65,000, if single—up from \$75,000 and \$55,000. The time limit on such deductions, which was 60 months, has been dropped. And you don't have

State-sponsored 529 college savings plans—many of which offer investment options similar to mutual funds—have become a lot harder to resist. As of Jan. 1, you can take money from these accounts free of federal taxes. Uncle Sam had previously taxed the account's earnings at your child's income-tax rate upon withdrawal.

These savings programs have become more flexible, too. You



NOAH WOODS

Tax Breaks For Schooling

PLAN

**COVERDELL
EDUCATION
SAVINGS ACCOUNT****

**EMPLOYER-
PROVIDED
EDUCATIONAL
ASSISTANCE**

**529 COLLEGE
SAVING PLANS**

**HIGHER EDUCATION
EXPENSES**

STUDENT LOANS

NEW BENEFITS

Limits on contributions rise to \$2,000 a year per child; money can be used at elementary and secondary schools

Up to \$5,250 a year can be excluded from income; benefit applies to graduate and undergraduate courses

Earnings grow free from federal taxes

Deduction of up to \$3,000 a year in tuition and related fees

No time limit on deduction of up to \$2,500 in annual interest payments

INCOME LIMITS*

Contributions phase out at \$190,000-\$220,000 (married); \$95,000-\$110,000 (single)

Not more than 5% of the amounts paid can go to business owners or their spouses or children

No restrictions

\$130,000 (married); \$65,000 (single)

Deduction phases-out at \$100,000-\$130,000 (married); \$50,000-\$65,000 (single)

* Adjusted gross income ** Formerly called the Education IRA

to itemize your return to take this deduction, which makes the benefit accessible to those with simple returns, says Jim Seidel, senior manager at RIA, a New York provider of tax information to accountants.

This year also marks the debut of a deduction for up to \$3,000 of higher-education tuition bills for you, your spouse, or child. That rises to \$4,000 in 2004, before ending in 2006. Married couples earning less than \$130,000 qualify, as do singles with income below \$65,000. (In 2004 and 2005, couples earning between \$130,000 and \$160,000 and singles making from \$65,000 to \$80,000 can deduct a more modest \$2,000.) Keep in mind that you can't deduct tuition paid with Coverdell money or 529 earnings, says Hurley. So, as with all the items in this smorgasbord of options, be sure to crunch the numbers before deciding which is the right way to go. ■

Three More For Your Checklist

BY MIKE McNAMEE

The tax package has many other features, but many don't take effect this year. Of those that do, these three may be worth your scrutiny:

■ **THE AMT.** Every silver lining has a dark cloud—and the shadow on the 2001 tax cut is the alternative minimum tax. It's a parallel tax code

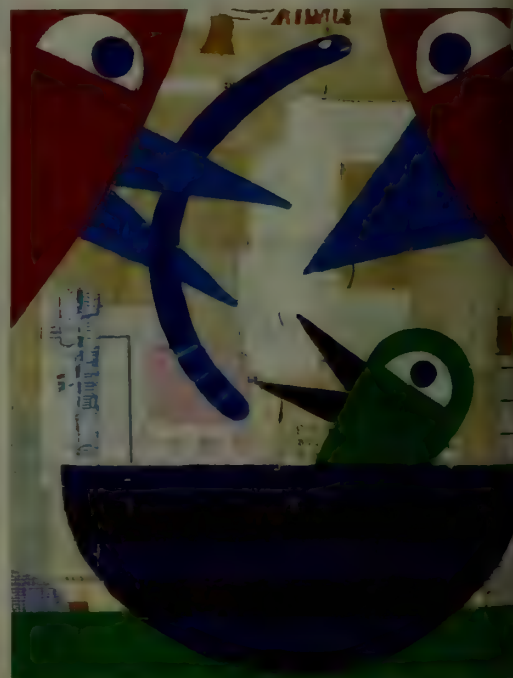
designed to catch fat cats who use exo breaks. Trouble is, lower ordinary rates the 2001 tax cut will cast more taxpayers the AMT net because their tax bill like drop to a level below the "minimum." So income is over \$150,000, you may have through a second tax calculation that takes such breaks as deductions for state and income taxes. "It's like not getting a tax cut all," says Don Weigandt, vice-president Morgan Private Bank in Los Angeles.

■ **DEEMED SALES.** If the stock market hard in 2001, use some losses to reduce tax 2006. Under a 1997 law, investors can get a lower tax rate on capital gains—18% instead of 20%—on property held five years or longer that applies only to assets acquired after Jan. 2, 2001. For assets bought earlier, you have a one chance now to start the five-year clock by selling and repurchasing the stock on Jan. 2, 2001. This "deemed sale" requires you to pay taxes now on gains through 2000, but change for getting the two-point rate break in 2006. Here's where the 2001 losses come in: If you have more net losses in 2001 than the deductible against ordinary income, you can use those to offset gains on the deemed sales. "If you have stock you're certain to hold until 2006, it can make sense," says Steven Hurok, tax director for accountants BDO Seidman.

■ **ADOPTION TAX CREDIT.** Thinking of adopting? You have a lot to gain in 2002. The adoption tax credit doubles, covering up to \$10,000 of expenses. A single parent or married couple adopting a child up to \$150,000 can take the full credit. Those with income up to \$190,000, up from \$115,000 in 2001, get a modified benefit.

Employers offering adoption assistance can deduct \$10,000 of expenses without tax consequences for the employee, up from \$5,000. But you choose between this benefit or the credit.

YOUR TAXES



There's More Than One Way to Tally Capital-Gains Tax Tab

When you pay up, choose the share-cost calculation that benefits you most

BY LEWIS BRAHAM

Online investing and toll-free telephone service make selling your mutual-fund shares a snap; accounting for that sale at tax time is anything but. The Internal Revenue Service allows investors to choose from several methods of reporting gains and losses, and which method you use to calculate those numbers makes all the difference.

Keep that in mind as account statements and 1099-Bs—the form the fund company will also send the IRS—arrive this month. If you sold mutual funds in a taxable account in 2001, you'll have to consider these issues before Apr. 15. Of course, it's even better if you think about the varied tax consequences before you sell a fund—or stocks for that matter, since the same rules apply to them.

The key to a smart sale is understanding “cost basis,” the price you paid per share for a fund. Figuring that out can be tricky because investors rarely buy all of their fund shares at a

YOUR TAXES

single price. If they're putting a fixed amount of money into a fund every month, they'll own numerous share lots, each purchased at a different price. That's not all. Most investors reinvest their dividend and capital-gains distributions, which are also purchases, creating more share lots. These distributions, when reinvested, become part of your cost basis. And if you paid any transaction fees in buying or selling, you have to adjust your costs for those, too.

Most people use an average cost-basis calculation, in part because it's the simplest and often available from brokers and fund companies. The average cost is the total amount invested in the fund divided by the number of shares you have purchased. If the price at which you sold or plan to sell a fund is higher than the average cost, you've got a profit; lower, of course, produces a loss. But the simplest meth-



ods are not necessarily optimal for reducing your tax burden.

To see how these methods work, we have come up with a hypothetical account in a real fund, Vanguard Capital Opportunity Fund (table). We started with a \$25,000 investment in January, 2000, made several other investments, and reinvested dividends and capital gains. We cashed out on the last day of 2001.

Start with the simplest calculation. You invested \$50,000 out of your pocket over the two-year period and an additional \$2,724.58 from distributions, so the total cost is \$52,724.58. With those investments, you have accumulated 2,327.83 shares. (Unlike stocks, mutual-fund purchases almost always include fractional shares.) Divide

the total cost by the number of shares, and get an average cost per share of \$22.65.

So is there a gain or loss? On Dec. 31, 2001, Vanguard Capital Opportunity's share price was \$23.62. Subtract your \$22.65 average cost, and you get a gain of 97¢ a share. Simple, sure, but you're not finished. The IRS considers gains on fund shares held longer than one year as long-term gains and takes a maximum of 20% of the gains, vs. as much as 39.1% for short-term gains. In this case, you have 1,331.99 long-term shares purchased in 2000. Multiply that by your average gain, and you have a \$1,292.03 long-term capital gain. Do the same for your 995.84 short-term shares, and you have a \$965.96 short-term capital gain.

Minimizing The Tax Hit

When selling a mutual fund, most people use their average cost as the basis for determining whether they made or lost money. But the IRS allows you to use other methods, which, depending on your situation, may result in lower gains or larger losses. Here's a hypothetical account using the Vanguard Capital Opportunity Fund.

INVESTMENT DATE	AMOUNT INVESTED	PRICE/ SHARE	SHARES PURCHASED	TOTAL SHARES
JAN. 5, 2000	\$25,000.00	\$23.17	1078.98	1,078.98
MAR. 16	5,000.00	32.72	152.81	1,231.79
DEC. 15 Reinvest Income	197.09	25.57	7.71	1,239.50
Reinvest Cap. Gains	2,365.04	25.57	92.49	1,332.00
MAY 22, 2001	5,000.00	27.23	183.62	1,515.62
SEPT. 21	15,000.00	18.63	805.15	2,320.77
DEC. 14 Reinvest Income	162.45	22.98	7.07	2,327.84

On Dec. 31, 2001, the fund's net asset value price per share is \$23.62. The average cost per share is \$22.65. You've invested \$52,724.58 and the total value of your holding is \$54,983.34.

IF YOU ARE SELLING ALL OF YOUR SHARES, CHOOSE FROM THESE TWO METHODS:

SINGLE-CATEGORY Take the current share price of Vanguard Capital Opportunity, \$23.62, and subtract your average cost per share, \$22.65. That's a gain of 97¢ a share. With this fund, you have 1,331.99 shares held more than 12 months for a \$1,292.03 long-term capital gain; and 995.84 shares held less than 12 months for a \$965.96 short-term gain.

DOUBLE-CATEGORY Calculate two average costs—for long-term and short-term shares—and then deduct that from the fund's current price. You have 1,331.99 long-term shares with a \$24.45 average cost. With shares now \$23.62, you have a \$1,105.55 long-term capital loss. You also have 995.84 short-term shares with a \$20.25 average cost for a \$3,355.98 short-term capital gain.

IF YOU'RE SELLING ONLY SOME OF YOUR SHARES, CHOOSE FROM THESE THREE METHODS:

AVERAGE COST If you redeem \$5,000 from this fund using the average-cost method, you sell 211.69 shares at a gain of 97¢ a share (\$23.62 less \$22.65), a long-term capital gain of \$205.34. The IRS will assume that you sold the oldest shares first and did it with the single-category method, meaning the same average cost was applied to all of your shares. You can use the double-category method, but you have to declare that to the IRS.

SPECIFIC SHARES Sell your highest-cost shares, purchased on Mar. 16, 2000, at \$32.72. Those 152.81 shares, initially worth \$5,000, are now \$3,609.37—a long-term capital loss of \$1,390.63. Also sell the 183.62 shares purchased on May 22, 2001, for \$27.23 a share. That \$5,000 investment is now worth \$4,337.10—a \$662.90 short-term loss. These losses can be used to counteract other realized gains in your portfolio.

FIRST-IN, FIRST-OUT If you redeem \$5,000 from Vanguard Capital Opportunity without telling the fund which shares to sell, the IRS will assume you sold the oldest shares—those purchased on Jan. 5, 2000, at \$23.17. At the fund's current price of \$23.62, you would sell 211.69 shares, realizing a long-term capital gain of 45¢ a share for a total of \$95.26. Of the three methods of selling, this is often the least tax-efficient.

IRS calls this formula the "single-category method" because you're calculating just one average cost for every share.

If you have both long- and short-term gains or losses, it's worth your trouble to consider the double-category method. That's when you calculate two average costs, one for your long-term shares, another for the short-term. Although your total gain will be the same either method, the distinction between short- and long-term gains will differ. Neither method realizes the least short-term gains is the right one for most investors.

Now, let's look at the two average costs. For the short-term shares, it would mean \$20.25, for the long-term, \$24.45. Since the fund's sale price was \$23.62, you have a gain of \$3.37 per share for the 995.84 short-term shares—a total of \$3,355.98. Then you have a loss of 83¢ a share on 3,331.99 long-term shares. That's a total loss of \$1,105.55.

Even if you have no other long-term gains from your other investments, those long-term losses will offset some short-term gains. But you would still be left with a short-term gain of \$1.43, compared with \$965.96 in the single-category method. So, in this example, the single-category method works better.

The example presumed you sold all the shares. But what if at yearend you sold only a portion of them? Then it gets trickier. You could use the average-cost basis employed in either the single- or double-category methods. When you're selling part of your stake, the double-category method has an advantage in that you have the flexibility to pick from either your long-term or short-term shares. With the single-category method, the IRS immediately assumes you are selling the short-term shares first.

The problem with using average cost is that you can't maximize your losses and minimize your gains to the fullest extent. The best way to do this is the "specific share" method. In this approach, you get to cherry-pick the highest cost shares and hold on to the lower cost ones. "Nine percent of the time, selling specific shares is the optimal tax efficiency," says tax expert Langstraat of Parametric Portfolio Associates in Seattle.

Let's see how this method works, go back to the example. Look at the shares purchased on March 1, 2000, at \$32.72 a share. They're the most expensive shares in the account, and they also happen to be long-term. Sold on Dec. 31, 2001, those shares would produce a long-term capital gain of \$1,390.63. This can be used elsewhere to offset long-term gains you may have in your portfolio. Likewise, the shares purchased on May 1, 2001, at \$27.23 would generate a \$662.90 long-term loss, which could offset short-term gains. In the absence of any gains, you can

deduct up to \$3,000 a year in losses from your taxable income. If your losses exceed \$3,000, you can carry the difference over until future years.

The problem with the specific share method is that it requires a lot of detailed record-keeping. You have to know exactly which shares to sell and, should you be audited, be able to prove to the IRS that you sold those specific lots. According to tax rules, you must receive written confirmation from your fund company or broker that you sold those specific shares. But in practice, few financial institutions keep records of individual share purchases, preferring to aggregate the total. (Fidelity Brokerage Services is one notable exception.) So the record-keeping really falls on you. "If you've done everything you can to keep accurate records,

that's a pretty defensible position to the IRS," says Edward Fleming, a personal tax manager at PricewaterhouseCoopers.

If an IRS auditor thinks that you have skimmed on the record-keeping—didn't keep trading statements or letters to your broker requesting specific shares be sold—the auditor will assume that you sold the oldest shares of your fund first. This is known as the first-in, first-out method and is often the least tax-efficient way of selling shares, as the oldest shares of your fund are often the cheapest. You must also notify the IRS on your Schedule D (the form for reporting capital gains and losses) as to which cost-basis method you are choosing for a particular fund and stick to that method. If you used average cost in tax reporting for 2001, you cannot switch to another method for reporting on the same fund in future years. You can, however, choose different methods for other funds.

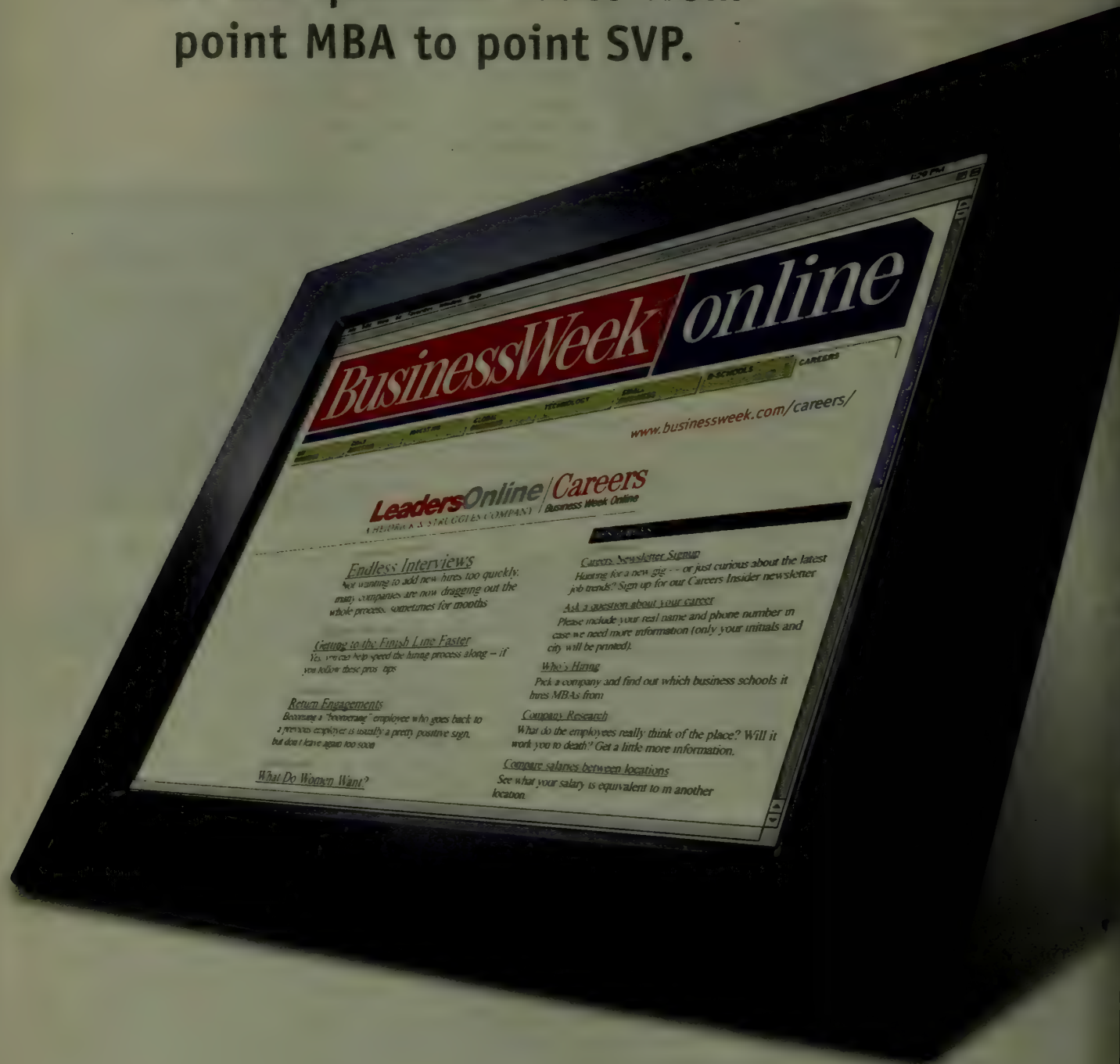
Luckily, software programs such as Quicken 2002 Deluxe can greatly facilitate your record-keeping. Quicken's program lets you download every trade you make at your broker or fund company into a spreadsheet, and when you're ready to sell, you can click an "average cost" button—using the single-category method—or a "minimize gain" button. Clicking the latter identifies your highest cost shares. When you sell, the program will calculate the capital gains or losses you have generated. Quicken's Web site and a competitor, GainsKeeper.com, also let you track share lots, but their programs are not as comprehensive.

Although working through the permutations of different cost-basis calculations can provoke headaches, the tax savings gained may be worth the extra time. A couple of aspirin and a sharp pencil could go a long way toward keeping the IRS at bay.

Most of the time, the specific shares method is the most tax-efficient. But it does require a lot of detailed record-keeping

YOUR TAXES

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TAX BITE TOO BIG ON OUR MUTUAL FUNDS?



ROBERT BARKER
businessweek.com

before
press would let
investors
off paying
capital-gains
tax until they
sell out: The
tax treatment
holders enjoy

Building Wealth

Deferring the tax on reinvested capital-gains distributions could help Americans grow wealthier. Here's the result of tax deferral on a hypothetical \$100,000 mutual-fund investment that returns 10% a year:

PERIOD	TAX SAVINGS*
1 YEAR	\$ 74
5 YEARS	445
10 YEARS	1,403
20 YEARS	3,461

*Assumes entire investment is liquidated at end of period.
Source: U.S. Congress Joint Economic Committee

Maurice Algazi barely knew what hit him. A strategic planner at a big food-service company and a careful investor from Gaithersburg, Md., Algazi nonetheless was shocked a couple of years back when his Franklin Templeton mutual fund made a huge capital-gains distribution. "It was pretty ugly," he told me. "My [taxable] income jumped by 30%." The next year, Algazi had to go through the rigmarole of estimating his taxes quarterly for the Internal Revenue Service.

Along with legions of other sadder-but-wiser fund investors, Algazi has shifted his money into more tax-efficient funds and begun to consider using an alternative to funds, such as an individualized account managed just for him. Good moves. But this is a case where it will take an act of Congress to fix mutual funds' maddening practice of saddling investors with unexpected tax bills.

Happily, legislation is in the works to do just that. It's called H.R. 168, sponsored by Representative Jim Saxton (R-N.J.). The bill would let most mutual-fund investors defer paying taxes on reinvested capital-gains distributions until they sold their fund shares, the same tax treatment that owners of stocks and most other financial assets enjoy.

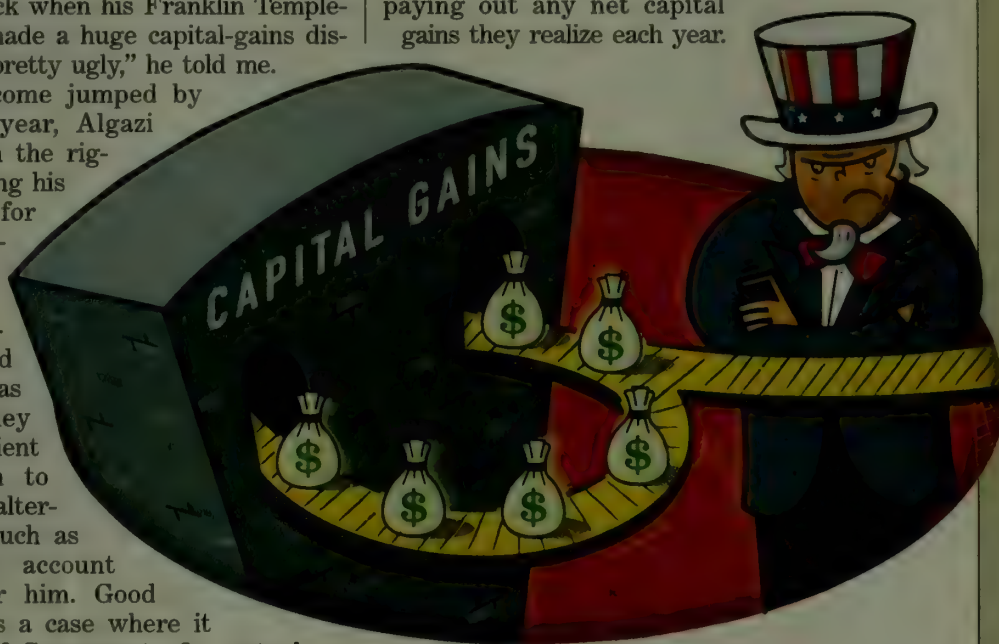
Saxton, who has represented a slice of central New Jersey since 1985, chairs the House and Senate's Joint Economic Committee. He told me he came up with the bill after going over his taxes with his own accountant a couple of years ago. "He said: 'Your capital gains from your mutual funds are X, Y, and Z.' And I said: 'How can that be? I didn't sell any mutual funds.'"

The congressman—like Algazi, perhaps like you, and definitely like yours truly—was shocked to learn how mutual-fund holdings are taxed. As the law stands now, investors owe a capital-gains tax if they sell fund shares at a profit. And they owe income tax on any distributions a fund pays out of dividends on stocks it holds or interest it earns on taxable bonds. But they also must pay a current tax on a fund's capital-gains distributions.

Each year, if the trades in a fund's port-

folio realize more capital gains than losses, the fund must pay out to investors their share of the net capital gains. A tax on those gains is due even if a fund holder never sees any cash but instead elects to reinvest the distribution in more fund shares. Most investors do reinvest. The fund industry's trade group, the Investment Company Institute, reports that 91% of capital-gains distributions in 2000 got plowed back into funds. That rate doesn't vary much year to year.

Under Saxton's proposal, funds would keep paying out any net capital gains they realize each year.



But fund holders who chose to reinvest their distributions would be able to defer the tax on up to \$3,000 in capital gains each year (\$6,000 on joint returns) until they sold their shares in the fund. Because fund holders could keep more capital invested, their holdings could compound faster, with real benefits to long-term investors (table).

As you've probably guessed, H.R. 168 offers no free lunch. Some investors could find their tax record-keeping turn even more onerous than it is now. And supporters estimate the cost to the Treasury at up to \$47 billion over 10 years. That's "not insignificant if we're looking at deficits" instead of surpluses in the federal budget, says Vanguard Group tax expert Joel Dickson. Just the same, Vanguard and such other fund complexes as Janus and T. Rowe Price took the unusual step of encouraging support for the bill among their clients.

As sensible as H.R. 168 may seem, it is far from a slam dunk. Saxton said he's heartened by garnering bipartisan support, plus friendly noises from the Bush Administration. But if you own mutual funds in a taxable account, it would not hurt one bit to make some favorable noise of your own on behalf of H.R. 168.

BusinessWeek online

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NE G. MARCIAL

Products, hit
Mexico's sugar
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For Corn Products International (CPO), it was like an earthquake. And the aftershocks may drive the company to look for a merger partner, argue some pros. With little warning, Mexico on Jan. 11 imposed a 20% tax on soft drinks made with high-fructose corn syrup—to protect domestic sugar growers. Corn Products, a major global corn refiner, derives roughly 10% of its revenues and 15% to 20% of its operating income from the Mexican corn-syrup operations. For 2002 and 2003, that translates to an earnings drop of 40¢ a share, figures Morgan Stanley's Kirstin Bucci.

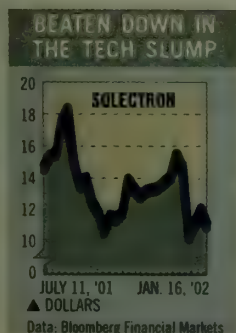
Investors were quick to bail out. The stock skidded from 31.20 to 28.20 on the day Mexico imposed its tax. But not everybody scooted: Indeed, value investor James Awad of Awad Asset Management bought. He thinks Corn Products is "attractively valued." The stock trades at its book value of 28 and sells at a price-earnings ratio of 13 times Awad's estimated earnings of \$2.10 a share in 2002, and 11 times estimated \$2.40 in 2003—adjusted for the Mexican tax.

Jeff Hershey, an analyst at Awad, says that if the tax sticks and if the stock stays where it is—or goes lower—"it's very possible management will take steps to protect the true worth of its business and enhance shareholder value." It could seek a merger or sell assets, says Hershey.

The stock was a poor performer even before Mexico made its move. He puts the company's replacement at two times book value, or more than 50 a share. He thinks any of the big players—including Archer Daniels Midland or Cargill—may be interested. Corn Products says it expects to resolve the tax issue but won't comment on what steps it would take otherwise.

SOLECTRON MAY BE SET TO HUM AGAIN

Value investor Robert Lyon thinks several tech stocks are ripe for picking: For the \$13 billion portfolio he shepherds at Institutional Capital, one of the stocks he considers a "solid value play" is Solectron (SLR). A top contract manufacturer of electronic equipment, Solectron saw its stock plunge from 42 in January, 2001, to 18 in August and to 9.65 by Dec. 21. Lately, it has inched up to 11. Lyon started buying when Solectron was at 10, confident that it would hit 18 in 12 months. The stock's runup will be driven, he says, both by the imminent end of the tech inventory



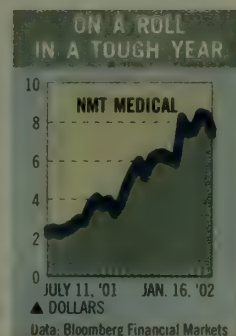
correction and the incipient economic rebound. Although Solectron remains debt-ridden, Lyon is encouraged by its restructuring moves to cut costs and beef up its balance sheet.

Early signs of a snapback in outsourcing—in North America and Europe—should be a boon to Solectron, says Lyon. In Japan, he adds, the "outsourcing phenomenon is just beginning," and that should create a new market for Solectron, although the U.S. will remain the largest. Lyon expects earnings to start rising. He sees Solectron earning 25¢ a share in the year ending Aug. 30, 2002, and 65¢ in fiscal 2003. His estimates are conservative—lower than First Call's consensus figures. With Solectron's buoyant prospects and its stock battered, Lyon believes the potential rewards far outweigh the risks.

NMT: PATCHING UP HOLES IN THE HEART

While other stocks were falling in 2001, shares of NMT Medical (NMTI) were on a roll. They picked up from 2 in mid-January, 2001, to 9.31 in late December, before easing to 8 this year. Its chief product, CardioSEAL, a minimally invasive treatment for holes in the heart, got Food & Drug Administration approval in December. It was approved in Europe in 1997. Such defects can cause blood to seep between the right and left sides of the heart—and could lead to blood clots and strokes, notes Kevin Kotler, senior medical analyst at investment outfit ABN Amro. CardioSEAL is threaded into the heart by a catheter to patch the hole.

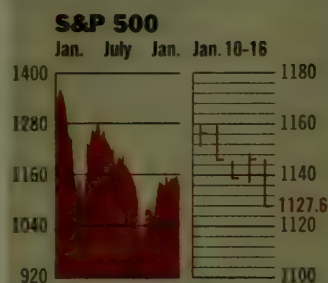
Richard Weinstein of vFinance Investments, which manages more than \$1 billion, has been accumulating NMT shares. He cites not only NMT's important products but also the prospect of a large medical-device maker buying the company sooner rather than later—because of the potential of CardioSEAL and other NMT technologies. "The recent acquisition by Medtronic of VidaMed, another small device maker, at 32 times revenues, puts a value of 20 a share on NMT," argues Weinstein. His estimate is based on 10 times estimated 2001 revenues of \$22 million for CardioSEAL alone, excluding NMT's cash hoard of \$30 million, or \$3 a share, and other assets. Weinstein estimates CardioSEAL sales in the U.S. and Europe will far exceed last year's. NMT didn't return calls.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:30 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

Markets tumbled as the earnings' season began and investors started re-assessing the outlook for profits. Dismal reports from Intel and J.P. Morgan Chase and the release of the Fed's Beige Book suggesting that the economy is weak sent stocks reeling on Jan. 16. Year-to-date, the Dow Jones industrial average, the Nasdaq, and the S&P 500 are back in negative territory.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Jan. 16	Week	Year to date	Last 12 months
S&P 500	1127.6	-2.4	-1.8	-15.0
Dow Jones Industrials	9712.3	-3.8	-3.1	-8.8
Nasdaq Composite	1944.4	-4.9	-0.3	-25.7
S&P MidCap 400	495.8	-3.3	-2.5	-2.4
S&P SmallCap 600	227.7	-3.2	-1.9	2.3
Wilshire 5000	10,514.1	-2.5	-1.8	-14.3

SECTORS

	Jan. 16	Week	Year to date	Last 12 months
BusinessWeek 50*	713.8	-3.6	-2.2	-28.9
BusinessWeek Info Tech 100**	414.0	-4.1	-1.3	-32.6
S&P/BARRA Growth	589.4	-1.6	-0.9	-13.7
S&P/BARRA Value	537.3	-3.1	-2.7	-16.8
S&P Energy	201.9	-3.0	-4.4	-13.2
S&P Financials	353.2	-0.7	-0.6	-9.0
S&P REIT	93.6	0.1	0.2	7.5
S&P Transportation	193.1	-4.9	-2.0	-4.4
S&P Utilities	144.2	-0.3	-1.2	-19.4
GST Internet	98.5	-10.9	-6.2	-50.0
PSE Technology	677.5	-5.8	-1.4	-20.4

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Casinos & Gaming	44.7	16.2
Metal & Glass Containers	44.3	16.1
Motorcycles	41.7	13.2
Office Electronics	37.7	10.6
Oil & Gas Refining	37.5	9.2

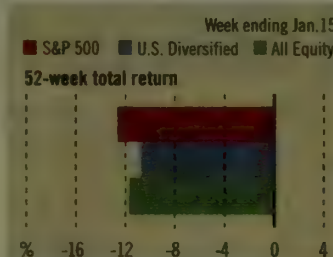
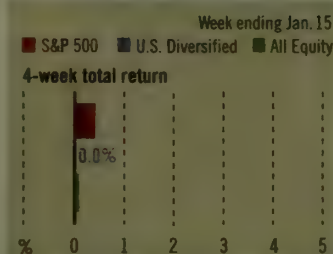
EQUITY FUND CATEGORIES

4-week total return %	52-week total return %
Leaders	Leaders
Precious Metals 6.9	Precious Metals 31.9
Diversified Emerging Mkts. 4.8	Small-cap Value 12.3
Pacific/Asia ex-Japan 3.6	Real Estate 11.5
Financial 2.3	Mid-cap Value 5.4
Laggards	Laggards
Communications -3.2	Communications -41.8
Health -3.0	Technology -36.5
Japan -2.8	Japan -29.3
Mid-cap Growth -1.3	Large-cap Growth -22.0

EQUITY FUNDS

4-week total return %	52-week total return %
Leaders	Leaders
American Heritage 55.6	CGM Focus 95.1
Pilgrim Russia A 16.4	Pilgrim Russia A 70.7
Frontier Equity 14.3	Schroder Capital Ultra Inv. 67.9
Van Eck Troika Dialog A 12.8	Am. Cent. Glob. Gold Inv. 50.9
Laggards	Laggards
World GenomicsFund.com -17.1	Berkshire Focus -71.1
Fidelity Select Wireless -12.5	Berkshire Technology -70.6
Amerindo Hlth. & Biotech. D -10.6	Merrill Lynch Focus 20 B -70.3
Liberty Newport Jap. Opps. B -10.3	ProFunds UltraOTC Inv. -69.4

Mutual Funds



Data: Standard & Poor's

THE WEEK AHEAD

LEADING INDICATORS Tuesday, Jan. 22, 10 a.m. EST ► The Conference Board's December composite index of leading economic indicators likely rose 0.5%, the same gain posted in November. That's based on the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies. The report will also contain annual revisions to the 2001 data.

FEDERAL BUDGET Tuesday, Jan. 22, 2 p.m. EST ► The U.S. Treasury is forecast to re-

port a December surplus of \$24.5 billion, compared with a surplus of \$32.6 billion in December, 2000, and a \$54.3 billion deficit in November. Through the first two months of fiscal year 2002, falling revenues and significant stimulus and defense expenditures have caused a \$63.7 billion deficit, compared with a \$35 billion gap for the same period a year ago.

INITIAL UNEMPLOYMENT CLAIMS Thursday, Jan. 24, 8:30 a.m. EST ► New filings for state unemployment benefits likely came

to 415,000 for the week ended Jan. 16. Because of office closings during the holiday season, jobless claims have been volatile recently.

EXISTING HOME SALES Tuesday, Jan. 22, 10 a.m. EST ► Sales of existing homes in December probably fell at an annual rate of 5.13 million, from 5.21 million in November. Based on the S&P forecast, existing home sales in 2001 reached 5.24 million units, eclipsing the high of 5.19 million houses in

GLOBAL MARKETS

	Jan. 16	Week
S&P Euro Plus (U.S. Dollar)	1024.5	-4.2
London (FT-SE 100)	5127.6	-1.9
Paris (CAC 40)	4425.5	-3.5
Frankfurt (DAX)	4984.2	-5.7
Tokyo (NIKKEI 225)	10,177.6	-4.8
Hong Kong (Hang Seng)	10,964.1	-4.2
Toronto (TSE 300)	7584.0	-2.5
Mexico City (IPC)	6579.4	0.3

FUNDAMENTALS

	Jan. 15	Week
S&P 500 Dividend Yield	1.36%	
S&P 500 P/E Ratio (Trailing 12 mos.)	47.5	
S&P 500 P/E Ratio (Next 12 mos.)*	22.3	
First Call Earnings Surprise*	5.13%	

*First Call Corp.

TECHNICAL INDICATORS

	Jan. 15	Week
S&P 500 200-day average	1167.1	1167.1
Stocks above 200-day average	58.0%	58.0%
Options: Put/call ratio	0.72	0.72
Insiders: Vickers Sell/buy ratio	2.52	2.52

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Multi-Utilities	-75.1	Wireless Service
Computer Storage & Perphs.	-73.0	Photographic P
Telecomms. Equip.	-66.7	Constr. & Engine
Wireless Services	-56.4	Diversified Chem
Instrumentation	-53.3	Instrumentation

Interest Rates

	Jan. 16	Week
MONEY MARKET FUNDS	1.73%	1.73%
90-DAY TREASURY BILLS	1.60	1.60
2-YEAR TREASURY NOTES	2.79	2.79
10-YEAR TREASURY NOTES	4.84	5.04
30-YEAR TREASURY BONDS	5.35	5.45
30-YEAR FIXED MORTGAGE†	6.86	7.21

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.31%
TAXABLE EQUIVALENT	6.25
INSURED REVENUE BONDS	4.48
TAXABLE EQUIVALENT	6.49

BusinessWeek Fifty

July

Jan.

Daily: Jan. 10-16

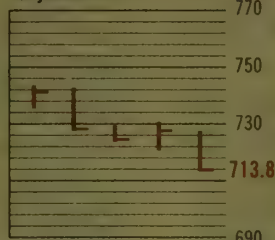
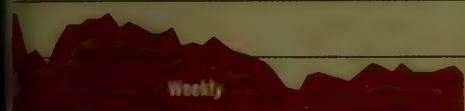
770

750

730

713.8

690



ged 3.6% for the week ended Jan. 16. Leading the decline was power company AES, with a % fall. Chip-equipment maker Teradyne fell 17.0%. Tyco International, the top-rated compa- after warning that profits would be disappointing. The week's bright spot, Provident Financial— still down 91.2% since the latest BW 50 was compiled.

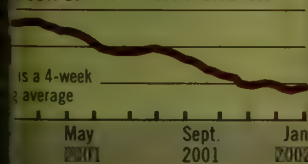
COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
ational	-13.6	-14.3	26	Verizon Communications	0.2	1.2
Petroleum	-6.9	-22.6	27	Citigroup	-2.6	-0.3
	-5.1	-66.5	28	Sun Microsystems	-10.8	-39.6
	-9.6	-49.9	29	Merck	-1.1	-27.0
Materials	-11.0	-8.3	30	El Paso	-8.4	-43.7
Financial	20.3	-91.2	31	Altera	-8.5	-8.8
Petroleum	-4.0	4.7	32	Marsh & McLennan	1.0	-1.9
	-4.1	-13.3	33	Household International	-5.3	-7.4
	-2.6	-18.6	34	ChevronTexaco	-2.1	0.5
	-0.9	-22.4	35	SBC Communications	-3.5	-19.0
Others Holdings	-6.3	-6.5	36	Mercury Interactive	-10.7	-45.2
	-10.1	-63.6	37	AOL Time Warner	-6.5	-33.0
	-71.1	-90.9	38	Washington Mutual	-2.9	-0.6
Laboratories	1.2	19.0	39	General Dynamics	-7.4	11.8
Financial	-3.0	-17.6	40	Comcast	-0.8	-16.2
Technology	-4.5	-6.8	41	Morgan Stanley Dean Witter	-4.3	-12.2
	-7.3	-0.5	42	Tellabs	-8.6	-64.3
ess	-2.8	-18.0	43	Exxon Mobil	-1.9	-5.5
ty	-1.9	-8.1	44	Scientific-Atlanta	-10.2	-48.0
Communications	-9.8	-55.2	45	U.S. Bancorp	-2.8	-13.3
Financial	-0.3	-3.1	46	Paychex	4.7	-6.1
Petroleum	-2.2	7.9	47	Merrill Lynch	-5.2	-8.3
ices	-10.2	3.2	48	Bed Bath & Beyond	-5.7	26.2
ices	-8.4	-21.3	49	Texas Instruments	-6.9	-19.0
Health	1.6	-6.2	50	Teradyne	-17.0	-7.3

Production Index

Change from last week: 0.3%
Change from last year: -10.9%

L OUTPUT Jan. 5=158.9 1992=100



index rose a second straight week for ce last August. Before calculation of the g average, the index fell to 158.9, from onally adjusted basis, autos and trucks est drops: *Ward's Automotive Reports* in January will be the weakest in over -freight traffic, coal, and electric pow- ere also lower. Steel rose sharply, with g and lumber also up.

of the index components is at www.businessweek.com
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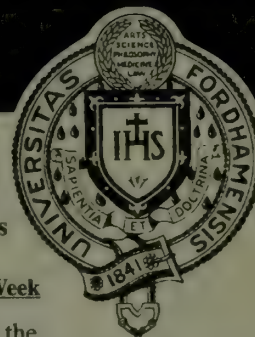
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HOW TO PREVENT FUTURE ENRONS...

There's plenty of blame to go around in the collapse of Enron Corp. The widening probe into the biggest bankruptcy filing in American history is turning up shocking failings by Enron's auditors, its lawyers, and most of all, its senior executives. The people in charge of running Enron engaged in financial chicanery that may well turn out to be criminal, and those who were supposed to monitor the company overlooked or even endorsed the most outrageous abuses. One of the few heroes to emerge from this sordid case is Sherron Watkins, an Enron finance executive who wrote a letter in August to Chairman and CEO Kenneth L. Lay that laid out in amazing detail the company's accounting tricks. Her letter, since made public, shows that Lay knew far more about misdeeds at the company than he has admitted.

The Enron implosion suggests that the balance between totally free markets and regulation has gotten out of whack. Massive government intervention would be a mistake. But reforms in fields ranging from accounting to energy trading to campaign finance (below) would go a long way toward removing financial incentives to violate the public's trust.

Let's start with auditors. Even leaving aside Enron, ag-

gressive accounting has become all too common. If investors can't trust companies' audited income statements and balance sheets, it will be harder for worthwhile enterprises to raise the funding that they need to grow. This week's Cover (page 44) spells out seven worthy ideas for cleaning up the auditing profession. They include putting tough limits on auditing firms' ability to consult for the companies they audit as well as limiting the ability of audit-firm partners to go to work for their clients.

Energy-trading deregulation may also need rethinking. Enron lobbied hard and successfully to get the trading of energy derivatives exempted from scrutiny by either the Securities & Exchange Commission or the Commodity Futures Trading Commission. That enabled Enron to take on enormous risks and big debts without disclosure, putting investors and holders in unrecognized peril.

The U.S. is firmly committed to a deregulated economy which tends to produce lower costs and more innovation through competition. But even deregulation can't flourish without appropriate ground rules and oversight. If investors feel that they are being deceived, capital won't get where it's needed. The growth of the U.S. economy will suffer.

...AND CAMPAIGN-FINANCE SHENANIGANS

In addition to the financial and criminal issues, the Enron collapse is also turning into an object lesson about how out of control campaign finance is. No company was better able to use money to grease its path than Enron. Over the past 12 years, Enron and its execs pumped \$5.8 million into campaign war chests, including donations to 71 current senators and 188 House members. Enron's most prolific year was 2000, when the company and its executives gave \$2.4 million to candidates, political action committees, and parties. That includes over \$50,000 to Attorney General John Ashcroft for his losing Senate bid, which now forces him to recuse himself from the Justice Dept. investigation of Enron. Most important, Enron and its execs were the top donors to George W. Bush throughout his political career, showering over \$700,000 on everything from his gubernatorial campaign to his Presidential inaugural gala.

Bush Administration officials rightly say Enron's contributions did not prompt any government intervention as it hurtled toward bankruptcy. Enron, however, was certainly able to buy access. Vice-President Dick Cheney and his top aides met with Enron execs six times in the past year as they developed the Administration's energy policy. Enron also threw its political weight around in Congress to avoid federal oversight of its energy-trading business. Enron's friends weren't all Republicans. In 1996, Enron donated \$100,000 to the Democratic National Committee soon after the Clinton Administration

helped Enron in a dispute with Indian government of

Meanwhile, Enron auditor Andersen and the other large accounting firms also greased the wheels. According to the Center for Responsive Politics, Andersen gave \$640,000 in the 1999-2000 election cycle to campaigns. The accounting industry as a whole contributed over \$5 million. These money flows largely helped the accountants avoid the tighter regulations favored by former SEC head Arthur Levitt Jr.—regulations that now seem essential.

What can be done? Banning soft money—unregulated contributions for party-building or for issue advertising—would have reduced by one-third Enron's contributions. A ban would make it harder for the company and its executives to give the huge amounts of money that afforded them nearly unlimited access. Also, Congress should strengthen disclosure laws to give the public more information about lobbyist contacts with elected officials and government staffers. Finally, it's time to ban "bundling," the practice where one executive can cash checks from employees and turn them over to campaign parties. This gives big corporations an edge in hard-money fundraising, while exerting unfair pressure on employees to do so.

By itself, campaign finance reform would not have saved Enron from misleading its investors. Still, Enron's campaign contributions helped it stave off the laws and regulations that might have restrained the energy giant from flying to the precipice.



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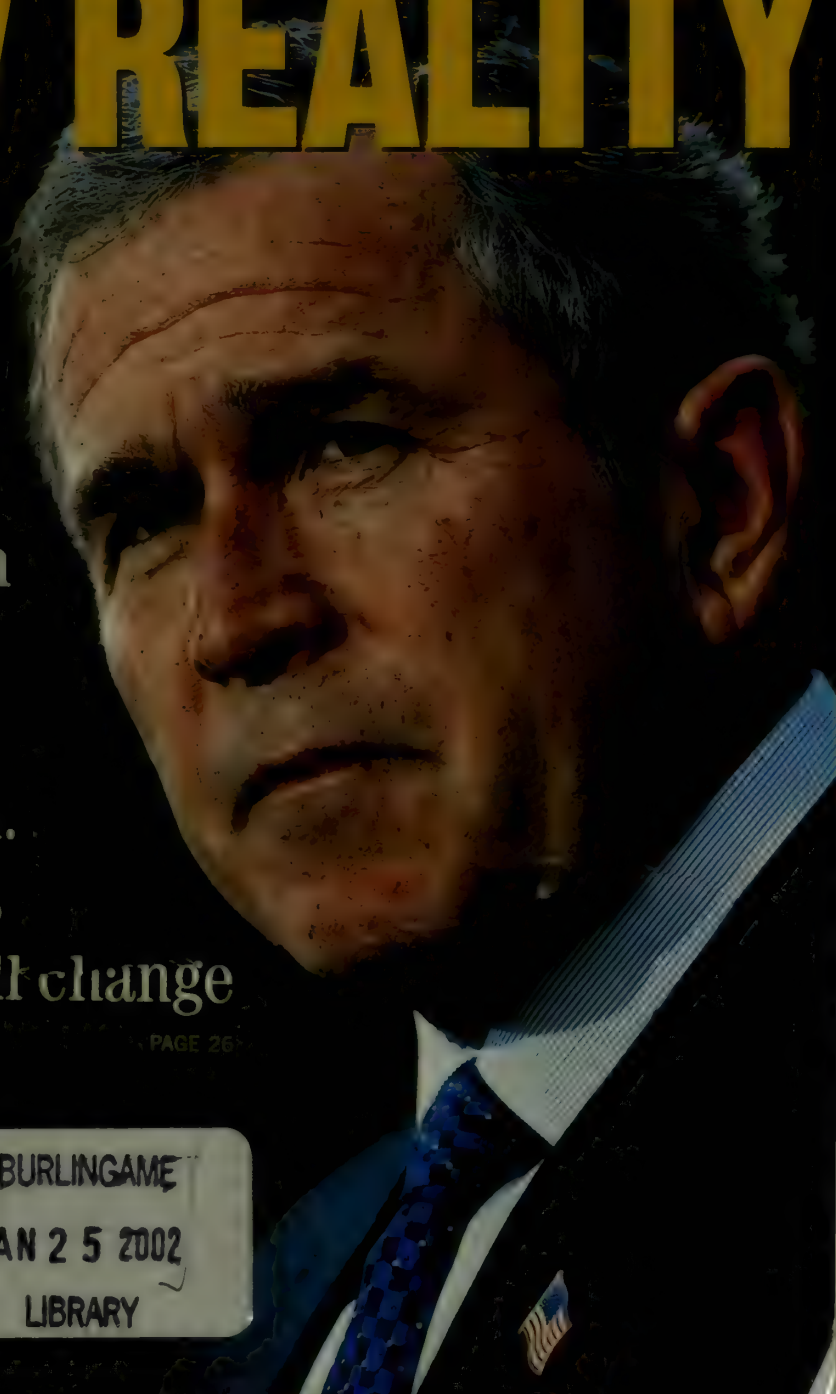
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BUSH'S NEW REALITY

Instead of governing in peace and prosperity, he must deal with war, deficits, and now the Enron scandal. Here's how his Presidency will change



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BUSH'S
NEW REALITY

The shift from peace and prosperity to war and deficits is forcing the President to rethink his agenda

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ENRON'S EX-CFO
His deal machine helped build the Enron empire.

Now
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No President in recent memory has had to cope with a more wrenching reversal of fortune than George W. Bush. Peace and surpluses gave way to war and deficits all in the space of a year. And now he must deal with the fallout from the Enron scandal, which has hit particularly close to home. Here's how all that is changing the way Bush governs

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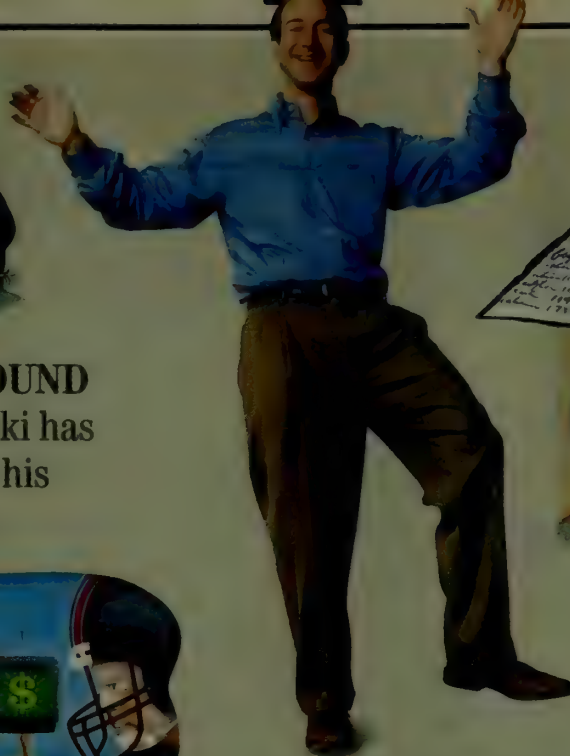
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Apple's Big Chance

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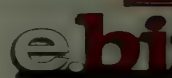
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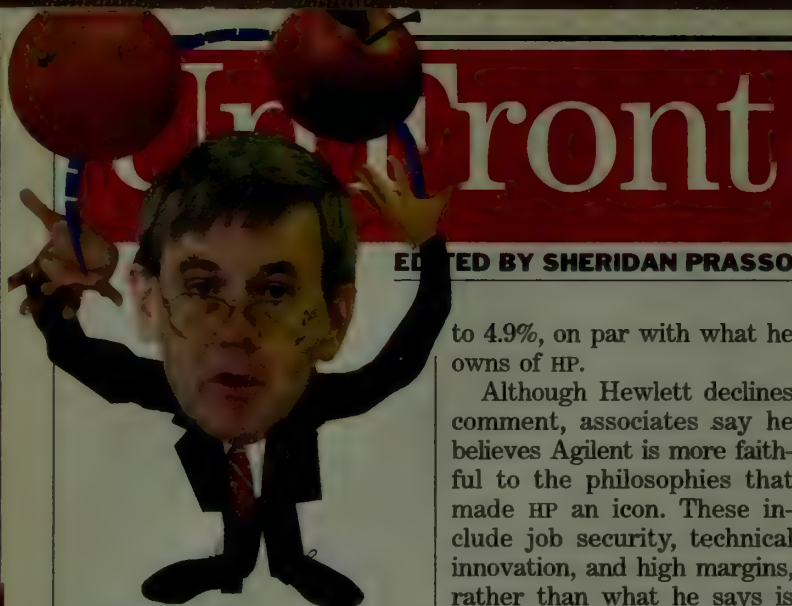
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SLUGFESTS

WALTER HEWLETT'S NEW PET: AGILENT

THERE'S AN INTERESTING sidelight to the ongoing feud over whether Hewlett-Packard should merge with Compaq Computer: HP director Walter Hewlett, who has publicly opposed the merger saying it's bad for shareholders, has been snatching up shares of Agilent Technologies, the HP spin-off where Hewlett is also a director. He's bought 575,000 Agilent shares since last February—including 70,000 since late June, when HP and Compaq began flirting, according to SEC filings. That brings the stake he controls in Agilent

to 4.9%, on par with what he owns of HP.

Although Hewlett declines comment, associates say he believes Agilent is more faithful to the philosophies that made HP an icon. These include job security, technical innovation, and high margins, rather than what he says is HP's fondness for marketing and market share. (Agilent descended from the original lab-equipment business Hewlett's father co-founded in 1939.) Says Agilent CEO Ned Barnholt: "Walter very passionately believes in the vision." Agilent has fallen 48%, and HP 40%, since the buying began.

HP's brain trust wouldn't be sorry to see Hewlett resign to focus on Agilent instead. In a Jan. 18 letter to shareholders, HP rebuked Hewlett, saying he believes "resting on our legacy is better than building on it." It's a good question whether HP will even renominate Hewlett for a board seat. A date for this year's annual meeting hasn't been set.

Timothy J. Mullaney and Peter Burrows

SEPTEMBER 11

CHARITY TOWARD ALL, INDEED

LAST FALL, AS \$1.5 BILLION POURED IN TO AID SEPTEMBER 11 victims, other charities began to fret. Their worry: that generosity toward those victims would siphon off funds needed for other causes. What would become of funding for the arts in Los Angeles? For homeless shelters in Chicago?

Well as it turns out, many charities didn't suffer the great sucking sound they expected. With the December giving rush now over, some are saying their dire predictions were too hasty. Of 18 local United Way campaigns, 12 met or exceeded their goals—one, in Texas, by \$2 million, or 6%. The Salvation Army won't have final numbers until February, but based on a sample of kettle drives, a spokeswoman says 2001 looks "on a par with last year." The trend extends even to small local groups thought to be the most in danger. "I'm happy to say we're holding our own," says Christina Thoburn of the University [of Michigan] Musical Society, which raises \$2.6 million a year for classical music and other performances.

All this has experts such as Eugene Tempel of Indiana University's Center on Philanthropy predicting that even excluding September 11 funds, charitable giving in 2001 will still match the \$203 billion level reached in 2000.

Nanette Byrnes

TALK SHOW "Is That All There Is?"

—Song made popular by Peggy Lee, who died Jan. 21

HIRED HELP

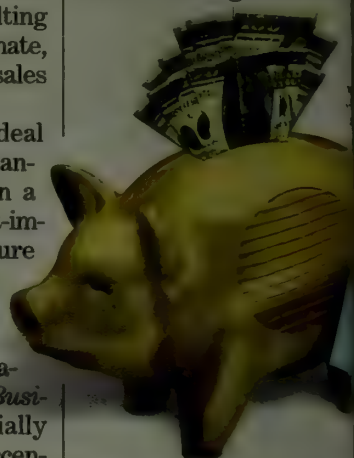
WHO'S ANSWERING AT&T'S PHONES?

IT MIGHT HAVE SEEMED LIKE a return to old, profligate ways. AT&T, which used to spend billions on consulting, announced Jan. 14 that it will now pay Accenture \$2.6 billion in a five-year consulting pact. Accenture will automate, revamp, and run AT&T's sales and customer service.

As it turns out, the deal may give AT&T a big financial boost. The key lies in a previously undisclosed-but-important detail: If Accenture can't stay within its \$2.6 billion, five-year-budget, it must "eat all the additional cost," a manager familiar with the deal tells *BusinessWeek*. That essentially puts all of the risk on Accenture. Accenture and AT&T won't confirm details. Accenture Partner Jon Harrington says he's "confident we will be able to deliver significant technology enhancements."

The financial structure of the deal clearly favors AT&T. The company would have spent \$5 billion over the next

five years on sales and customer service anyway. Accenture managing it for \$2.6 billion means a savings to AT&T of 50%. If Accenture can't reduce costs beyond that, AT&T will keep half the additional costs. But if Accenture can't stay within its \$2.6 billion, it must pay the shortfall. "The great thing about this agreement



can address the need for world-class customer service at 50% below the current rate," says AT&T Consumer Services Div. President Betsy Bell.

AT&T had tried to restructure customer service for years, but the task may be harder than it looks. Now, it's entirely up to Accenture. *Steve Rose*

THE LIST ENRON COLLECTIBLES ON EBAY

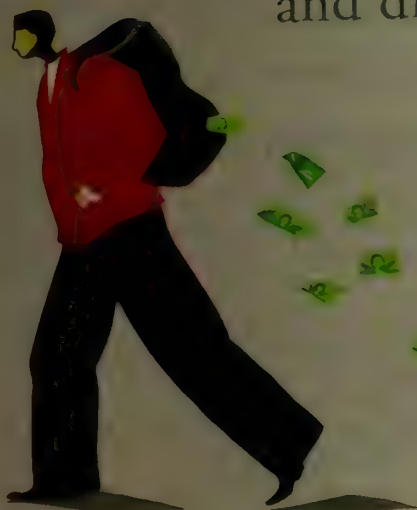
Enron items are hot, with more than 1,000 sold so far on eBay. Ethics handbooks—plenty in mint condition—are in high demand among sellers. (Did you expect 'em to be dog-eared and well-read?)

ITEM	PRICE	DESCRIPTION
ENRON RISK MANAGEMENT MANUAL	\$1,025	Tips on reorganizing expenses to improve perception of financial performance
Code of Ethics	\$46-\$300*	64-page paperback sections on Conflict of Interest, Securities Trades by Employee
ENRON "RETIREMENT PLANNING" MUG	\$61-\$300**	Emblazoned "Enron Retirement Planning" tools and imagination for your future
"TEAM ENRON" CYCLING JERSEY	\$82	Size XL, worn by a cycling team member in a Houston race

*56 sold as of press time, Jan. 23

**6 sold as of press

This is the story
of the investor who
lost \$31,701
and didn't even know it.



There are investors who choose to believe that the fees charged for managing a mutual fund involve money they weren't entitled to in the first place. Truth is, it's all yours. And the impact of fees on performance over time can be significant.

For example, take a hypothetical fund with an expense ratio of 1.3 percent, versus one with an expense ratio of just 0.2 percent. Applied to an initial \$25,000 investment returning 10 percent, and compounded over 20 years, the difference adds up to a not-so-insignificant \$31,701. In your account.

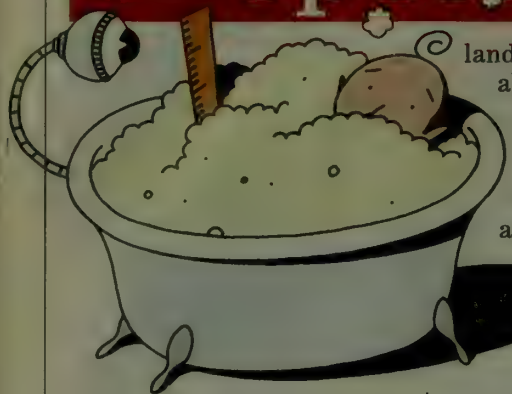
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Up Front



landlord, the setup costs about \$500 per apartment, plus \$3 or so a month.

Archstone-Smith, which rents out 80,000 apartments nationwide, estimates that it spends \$40 a month per apartment on water—an amount it tries to

recoup in rent. In the past few months, however, Archstone has been installing meters in 900 rental apartments in Washington, D.C., and plans to add 2,000 more, mostly in Florida, this year. "It is really fair and right for tenants to pay for their own water," says Archstone's chief information officer, Daniel Amedro. "We like this solution a lot."

By billing renters for the water they use, landlords also might encourage water conservation, which is why some environmentalists like the device, as well. But some tenant advocates are flush with anger. Says Kathy Brown, coordinator of the Boston Tenant Coalition: "This just feels like another way to create more wealth for landlords." Well, uh, maybe they'll kick back the \$40 from the rent. *Michael Arndt*

RENTER BEWARE

MORE MONEY DOWN THE DRAIN

IS NOTHING PRIVATE ANYMORE? Your bosses snoop through your e-mail. Strangers gawk at your unmentionables as airport screeners paw through your luggage. And now, there's a gadget that lets your landlord know how many times you flush the toilet and how often you bathe. Then, you get the bill.

The wireless device, sold by startup Wellspring International of San Diego, is about the size of a deck of cards and can be attached to every water pipe in an apartment. It monitors water flow and beams the data every eight hours to an in-building computer. For the

DRAWN & QUARTERED



STAMP OF REPROVAL

CAN THE POST OFFICE DO E-MAIL?

THE BELEAGUERED U.S. POSTAL Service can't catch a break. If anthrax-tainted mail and falling revenues weren't enough, now comes a scathing report on its foray into electronic commerce.

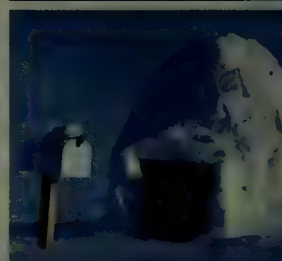
Post office attempts to get into Internet bill payment, online stamp sales, and other e-commerce ventures generated only about \$1 million last year. That's less than 1% of the post office's own \$104 million e-commerce projections for 2001, a General Accounting Office study found. The GAO said slow public adoption of services, "fragmented" management, and "inconsistent" implementation were to blame. For example, the Postal Service revamped internal rules for developing e-commerce initiatives twice in just one year. On the sloppy accounting front, online stamp sales weren't counted as e-commerce revenue, even though all costs for it were reported as e-commerce costs.

In a written reply, Deputy Postmaster General John Nolan says the report neglects a September restructuring that brought all marketing, including e-commerce, into one division and tightened management control. He also says the Postal Service has more clearly defined its e-objectives.

A USPS spokeswoman hints at new online services beyond

e-payments, money transfer, online greeting cards, a transmission of documents that are printed and mailed. "Having these online services is more convenient for our customers," she says. The Postal Service charges for transactions (\$6.95 for 20 e-payments, for example), so it's one way of supplementing falling sales. *Amy B...*

THE BIG PICTURE



BRRRR! CLICK, CLIK

Too cold to go out? Alaskans and New Englanders spent the most on online holiday purchases.

STATE	ONLINE SALES PER RESIDENT
ALASKA	\$37
NEW HAMPSHIRE	\$33
CONNECTICUT	\$31
VERMONT	\$30
MASSACHUSETTS	\$30
VIRGINIA	\$29
WASHINGTON	\$28
DISTRICT OF COLUMBIA	\$28
NATIONAL AVERAGE	\$20

From 2,000 e-commerce sites, Nov. 19-20. Data: BizRate.com

BARGAIN-SHOPPING @ EXCITE@HOME

Internet access provider Excite@Home is bankrupt, and some of its prized pieces are selling for pennies on the dollar; if that. Creditors, with \$1 billion in claims, will be lucky to get \$400 million. Here's a look at where the parts of a company that two years ago had a market cap of \$17 billion are ending up:

WEBSHOTS Excite paid \$82.5 million for the photo site in 1999. In January, its founders bid \$2.4 million and bought it back.

MatchLogic Assets of the ad-tracking site were divvied up at auction in December. The total take: \$2.2 million. Excite paid \$89 million to purchase MatchLogic in 1998.

Excite InfoSpace and iWon paid \$10 million to take over the portal in November. In 1999, @Home paid \$6.7 billion.

Blue Mountain AmericanGreetings.com snagged the greeting-card site in September for \$35 million. In 1999, Excite@Home paid \$780 million for the site.

An auction for @Home's fought-over cable assets, expected to bring in some \$25 million, is slated to end in April. *Kimberly Weisul*

Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com

A New Vision of Corporate Learning

Accenture and Avaya Advance
to Head of Class, Transforming
Standards for Global Training

at ex... nts show that collabo

{ Now it gets interesting. }

Improving the performance of thousands of people through one of the largest engagements of its kind, Avaya, a global leader in networking solutions and services, has outsourced corporate learning

operations to Accenture.

Accenture will deploy the latest Web-based learning solutions in combination with traditional classroom training to create a uniquely networked learning system that extends the reach of

learning solutions in a more cost-effective manner.

Accenture is pleased to be playing a major role in the future of this forward-looking company.

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EDS: SETTING THE RECORD STRAIGHT

"Who else is hiding debt" (Special Report, Jan. 28) did a tremendous disservice to EDS, our shareholders, and *BusinessWeek's* readers. It was inflammatory to compare EDS with companies with hidden liabilities. We have none. While we discussed the issue in general with a *BusinessWeek* reporter, no one contacted us for this specific story. Had we been contacted, we would have explained that:

EDS does not engage in "off-balance-sheet" debt transactions. We arrange financing on behalf of our customers with third-party financial institutions. This customer financing covers IT-related capital assets (most notably computer hardware).

We do not include third-party financing in the total contract value we report, nor is it ever part of our financial statements as either revenue or profit. These transactions are separate from EDS.

We arrange third-party financing principally to reduce EDS' risk. The financial institution assumes all credit risks associated with the repayment of the customer loan. The only exposure for EDS is in the unlikely event of nonperformance by EDS, which would permit the customer to terminate the contract. In EDS' entire history of arranging this type of financing, we have never had to repay a customer loan due to contract termination for nonperformance. EDS assumes the risk for nonperformance in any outsourcing contract, whether it involves financing or not.

Consistent with generally accepted accounting principles, EDS discloses the outstanding balance of these loans as contingent liabilities. We have

lengthy discussions about them with the rating agencies. The rating agencies do impute a small percent of the outstanding amount to EDS, riving at our A1/A+ ratings—the highest in the industry. This reflects their comfort that all we is a small residual risk associated with performance of IT services.

I think your readers will agree that this is a far cry from the "balance-sheet bombshell" your article characterized. It is simply good business practice and risk management. We ask you to set the record straight.

Scott
 Vice-President and Treasurer

Editor's note: We regret that we did not give EDS a fuller opportunity to respond, and we are happy to print the company's detailed response.

THEY'RE NOT EVERYONE'S TOP 25 MANAGERS

I am somewhat amused by your article including Robert A. Eckert of Mattel among your 25 managers. In the "Cover Story, Jan. 28" [Setting] a goal at 25% that achieves similar prior performance (i.e., compared to Wars merchandise) is absurd.

Certainly a relevant brand manager must have loved this business decision, especially bonus time, as he or she will expect to meet that goal. Alternatively, the decision should not make investors happy, based on lost profits; not



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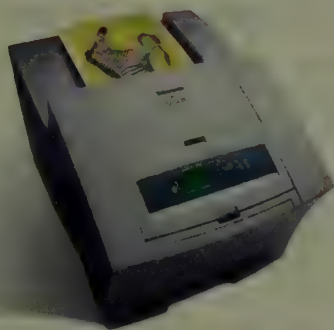
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Readers Report

CORRECTIONS & CLARIFICATIONS

"Accounting failures aren't new—just more frequent," the timeline graphic accompanying "Accounting in crisis" (Special Report, Jan. 28), misidentified the lawsuit Ernst & Young settled for \$335 million. The suit they settled was with shareholders. They are still in litigation with Cendant.

employees, based on the lost potential for employment. The idea of setting a goal this low seems unworthy of a major company CEO.

Michael Carlton-Jones
Cincinnati, Ohio

We all love Oprah. But Oprah as one of the "Top 25 managers of the year"? Give us a break! Oprah is to business management what Dennis Tito (who paid \$20 million to ride on a Russian spacecraft) is to space exploration.

Edward A. Brown
Stow, Mass.

If Brian Roberts is a "Manager to watch" in 2002, he's certainly not managing his broadband service properly. The transition from Excite@Home to Comcast high-speed Internet service has been a total disaster. Comcast has badly damaged its reputation in northern New Jersey by not being prepared for Excite@Home's liquidation.

Richard Slocum
Summit, N.J.

A BOON FOR TUTORS —AND TEST MAKERS

"A new push to privatize" (Education, Industry Outlook, Jan. 14) identifies some valuable openings for the private sector with the passage of President Bush's No Child Left Behind Act but misses perhaps the most important: Under the "supplemental services" section of the new law, parents of children stuck in failing public schools will be able to use their entire share of Title I aid—\$500 to \$1,000 per child—to purchase private tutorial services.

Tutoring, after-school, and summer-school programs, including those of private or religiously affiliated organizations, are all eligible for these funds. A congressional analysis estimates children attending nearly 3,000 failing schools would qualify for this program immediately.

This new federal program not only introduces market forces into a sector desperate for their infusion of innovation.

It presents the education industry with a powerful new direction for growth.

Don Soifer
Lexington Institute
Arlington, Va.

CONSULTANT, HEAL THYSELF

The 2002 outlook for professional services is indeed grim ("First, kill the consultants," Industry Outlook, Jan. 14). But the recession is not entirely to blame. Consultants have been the first to preach customer-relationship management, brand management, innovation, strategic alliances, and outsourcing to their clients—but the last to adopt such practices themselves.

By adhering to outdated business practices, the professional service industry has become rife with inefficiency, commoditization, and conservatism. Could it be that the consultants are in need of consultants?

Mark S. Bonchek
Concord, Mass.

A PRODUCTIVITY GAUGE THAT INCLUDES INFLATION

I applaud the use of "economic value added per employee" as a productivity indicator in charts accompanying the 2002 Industry Outlook (Jan. 14). It is much more valid than traditional "sales per employee," as you point out. An even more valid measurement is "economic value added per cost of employees," since inflation is included in both sides of the equation. The difficulty with VA per cost of employees is that the cost of employees is omitted from financial statements: balance sheet, profit-and-loss statement, and cash flow.

Henry Dahl
Tucson, Ariz.

BIOTECH IS MORE LIKE THE TORTOISE THAN THE HARE

Despite Paul Raeburn's expectations of a biotech boom, the bubble may turn out to be just foam ("A biotech boom with a difference," News: Analysis & Commentary, Dec. 31). Unlike the Internet Big Bang, biotech will not have the impetus of online commerce or the productivity enhancement from digital hardware and software. There is no such quid pro quo to be derived from pharmaceutical purchases.

Biotech's market will be real and relentless, but it is unlikely to create a potential economic panic and job derailment—at least not on the order of the

present downturn. It should rise steadily without the riptide of an exorbitant swell followed by a pelting crash. For a long-term investment, yes. For a short-term windfall, no.

R. Lyman
Chippewa Falls

MAYOR BLOOMBERG NEEDS MORE THAN LUCK

I enjoyed your Jan. 14 editorial about Michael Bloomberg until I got to the last sentence. Only then did I learn the title, "Good luck, Mayor Bloomberg." This story emphasized Bloomberg's good times and past successes. It was quite a buildup. At the end, you only wish him luck. If you really feel he is as lucky as you indicate, why not wish him success? While luck may play a role, a more important role is the person's ability and efforts.

Frank C. H.
Fairview Park,

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BY STEPHEN H. WILDSTROM

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BIG-SCREEN JUST GOT A LOT BETTER



Projectors aren't just for slides anymore. Home-theater enthusiasts as well as road warriors will find that the latest are worth a look

Not so long ago, the video projector was an expensive and mysterious beast presided over by corporate audio-visual experts. But in the past few years, it has become a standard tool in the kit of ordinary folks who give presentations. And if manufacturers are right, easy-to-use projectors may soon be making their way into many home-entertainment systems.

I looked at two new projectors. One, the ScreenPlay 110 from InFocus (www.infocus.com), is the first of a new breed designed to display movies or TV shows rather than PowerPoint slides. The other, the two-pound V-807 Series from PLUS Vision (www.lightware.com), takes projector portability to a new level.

Just about any projector can take input from a DVD player, set-top box, or other video source and throw it up on a screen. But projectors designed to work with computers don't do a very good job. They are optimized for the sharpest display of text and graphics, not video.

The ScreenPlay 110, however, has been heavily modified to improve video performance compared with its stablemate, the workhorse InFocus LP500 that is widely used for business presentations. The rotating filter wheel used to generate screen colors in projectors using the Texas Instruments Digital Light Processing system has been redesigned to give purer colors and higher contrast. The color temperature of the display has been lowered to remove the blue cast typical of data projectors and produce the warmer colors of broadcast TV. Special circuitry is used to produce a true high-definition TV progressive display when connected to an HDTV source, and the image is the 16:9 widescreen ratio used for movies and HDTV. The projector also accepts just about any video connector: digital and analog computer output, S-video, and composite or component (red-green-blue) video.

In a data projector, the brightest possible lamp is desirable because it allows use in normal conference-room lighting. But a home theater can easily be dimmed, so the ScreenPlay uses a lower-output lamp than the LP500. The result is a quieter system, because there is less need for cooling, as well as longer lamp life.

The sum of these changes is a superior system for TV or movie projection. The images lack the harshness of data projectors and are free of the shadows and block pixels that often mar other

projector images, especially in fast action scenes.

The biggest drawback is the \$4,999 cost. At a time when you can buy a 60-inch high-resolution projection TV for around \$3,000, that's pretty steep. But the ScreenPlay can throw a high-quality image with a 12-foot diagonal onto a plain white screen that costs a few hundred dollars. If you ceiling-mount the projector, which also gives you the best image quality, the system takes up virtually no space in a room. And InFocus plans to drive down the price of home video projectors sharply. By later in the year, it hopes to offer a consumer projector for less than \$2,000 that will offer bigger and probably better (because of advantages of front-projection) images at a lower price than projection TVs.

Unlike the uncompromising, special-purpose ScreenPlay, the PLUS V-807 has to make a name



SCREENPLAY 110

What's New

	ScreenPlay 110 from InFocus (www.infocus.com)	V-807 from PLUS Vision (www.lightware.com)
PRIMARY USE	Home entertainment	Mobile presentation
DIMENSIONS	10.4x11.1x3.3 in. 6.7 lb.	7x5.6x1.8 in. 2 lb.
BRIGHTNESS	1000 lumens	800 lumens
ZOOMS LENS	1.2X	No
PRICE	\$4,999	\$2,295

Data: Manufacturers

number of sacrifices in exchange for maximum portability. There are only two video inputs, computer and composite. There's no zoom lens, and it's less bright than even the ScreenPlay, so you probably want to dim the lights. It's relatively noisy, and you'd probably be better off using the mediocre audio from most laptops than the V-807's tinny sound. (The ScreenPlay provides decent sound, though hooking it up to a home sound system is better.)

The payoff for the PLUS V-807 is a versatile projector that is not only light but tiny. And at \$2,295 (\$3,195 for the higher-resolution V-108), it's a relative bargain in a market where small often translates into more expensive. And while it won't project video as well as the ScreenPlay, it's small enough to tuck into your briefcase and use over the weekend to project a movie or to game onto a big screen.

This is good news for both mobile executives and would-be home-theater owners. Increasing capabilities, greater ease of use, smaller packages and lower prices are turning projectors into mainstream products.

BusinessWeek online

A BETTER INTERNET THROUGH MATH? See a research report at Technology & You at www.businessweek.com/technology/

INVENIENT SPY

Ho Lee and the Politics of Nuclear Espionage
 Dan Stober and Ian Hoffman
 Simon & Schuster • 384pp • \$26

MY COUNTRY VERSUS ME

By Wen Ho Lee with Helen Zia
 Hyperion • 332pp • \$23.95

HE MAKING F A SCAPEGOAT

started with a tip. A walk-in defector from China offered papers suggesting that Chinese nuclear scientists had copied America's premier head, the W88. U.S. investigators at Los Alamos National Laboratory divided about whether China had the design, whether the defector was a plant, and what to make of the 100 mostly unremarkable documents eventually brought out from China. They reluctantly agreed there might be a mole at the lab.

Next came a suspect. After reviewing similar 1980s spy case and scientists' travel records and contacts, investigators settled on Taiwanese-born Wen Ho Lee as their target. "It's Wen Ho Lee we're gonna get him," Craig Schmidt, the FBI agent in charge, is quoted saying in *A Convenient Spy: Wen Ho Lee and the Politics of Nuclear Espionage* by San Jose Mercury-News reporter Dan Stober and Albuquerque Journal reporter Ian Hoffman. The well-reported volume is one of two new books on the case. The other, *My Country Versus Me* by Lee and Helen Zia, is Lee's personal, re-settling account.

Once under way, there was no turning back. FBI agent Michael Covert spent two years chasing Lee that she needed him to catch a Los Alamos spy working with China—hoping it would slip up. When that didn't work, the government played hardball. The Energy Dept.'s top investigator, Notra Trulock, leaked details of the case to *New York Times* reporters Jeff Gerth and James H. Hogue, whose Mar. 6, 1999, story, "China's Nuclear Secrets from Los Alamos, U.S. Officials Say," called the breach as damaging as that of the Rosenbergs. With the gloves now off, Covert spent the next day, a Sunday, trying to browbeat a confession out of Lee. "Look at this newspaper article! It all but says your name in here," she told him. "Do you know who the Rosenbergs are?" he added. "They electrocuted them, not Ho."

When Lee didn't crack, the government indicted him for espionage and kept him in solitary confinement for 278 days. Several times each week, he was driven, manacled, from Santa Fe to Albuquerque to meet with his lawyers. Finally facing failure, the Justice Dept. settled for a plea on only one of 58 counts. Lee had removed a dozen classified nuclear code tapes from the lab, sometimes making multiple copies. The government had once called the tapes the "crown jewels" of America's nuclear program. Lee said he was just protecting his work from a possible computer crash, something that had once happened. Fear of being caught led him to throw the tapes in a dumpster, he claimed, but they were never found. He pleaded guilty to a felony. His sentence was restricted to the time he'd already served.

At the hearing, James A. Parker, the conservative Texas judge who presided, said Lee's treatment "embarrassed our entire nation." He personally apologized to the scientist for his detention. The government, however, did not apologize, and neither did the *Times*, the publication that had pursued the case most aggressively.

So what really happened? According to both books, politics drove the prosecution. Janet Reno's Justice Dept. wanted to protect Bill Clinton from Republican charges that his Administration was lax on security. A congressional committee headed by Christopher Cox (R-Calif.) was about to uncork a report, heavily based on testimony by Trulock, alleging critical losses of nuclear secrets to China. Energy Secretary Bill Richardson, responsible for Los Alamos, was angling to become Al Gore's running mate. The FBI needed a big score. This constellation of factors created a spying Perfect Storm.

Once the facts were known, Wen Ho Lee became a celebrity among prominent Chinese Americans, who, like Lee, say he was victimized because of his eth-

nicity. Lee sees himself as the target of a government "sting" and expresses "particular disgust" toward the *Times*.

But, as Stober and Hoffman show, there were grounds for suspecting Lee. He'd had ample opportunity to meet with Chinese counterparts who were trying to get U.S. secrets, since the U.S. had approved personnel exchanges with Chinese scientists. When discussing some of these contacts, Lee was evasive. He failed one polygraph test. And, at 60, he was worried about job cutbacks. He had put out job feelers in Taiwan. Lee's breach of security—copying files and taking them home—was a firing offense, although Lee's lawyers argued that Clinton's CIA director, John Deutsch, was pardoned after doing the same thing.

But the tapes were hardly crown jewels. While prosecutors maintained that they were "top secret," they were really classed as "restricted data," two levels below secret or confidential. Lee says that at leaky Los Alamos, colleagues were using stacked printouts of such data as doorstops.

The bigger problem identified in both books was the melding of political opportunism with exaggerated government secrecy. Some scientists who testified for Lee argued that 90% of what the labs restrict is in the public domain, and that hundreds of copied sketches of the W88 were floating around at other labs and subcontractors' offices. They maintained that China could have easily gotten the information elsewhere.

Today, after September 11, you can't read *A Convenient Spy* without wondering what happened to the FBI. While chasing Lee and missing Russian agent Robert Philip Hanssen, it ignored evidence offered to it of the planned hijackings. If at some point a 9-11 inquiry gets launched, as seems warranted, Stober and Hoffman's account of this sorry case should be on the reading list.

BY BOB DOWLING

Dowling is International Managing Editor.



The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST
1	JACK Jack Welch, with John A. Byrne (Warner Business • \$29.95) <i>GE's ex-chairman reflects on his life and accomplishments.</i>	1	4	
2	WHO MOVED MY CHEESE? Spencer Johnson (Putnam • \$19.95) <i>Learning to accept change.</i>	2	36	
3	GOOD TO GREAT Jim Collins (HarperBusiness • \$27.50) <i>How run-of-the-mill companies make the leap to excellence.</i>	4	3	
4	FISH! Stephen C. Lundin, Harry Paul, John Christensen (Hyperion • \$19.95) <i>Motivate employees the Pike Place Fish Market way.</i>	3	16	
5	THE ROAD TO WEALTH Suze Orman (Riverhead • \$29.95) <i>Questions and answers from the queen of personal-finance counseling.</i>	7	6	
6	FIRST, BREAK ALL THE RULES Marcus Buckingham, Curt Coffman (Simon & Schuster • \$26) <i>A Gallup probe into managerial success.</i>	5	32	
7	NOW, DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • \$26) <i>How to bolster your true talents.</i>	6	11	
8	NICKEL AND DIMED Barbara Ehrenreich (Metropolitan • \$23) <i>Life among the working poor.</i>	12	3	
9	THE 21 IRREFUTABLE LAWS OF LEADERSHIP John C. Maxwell (Thomas Nelson • \$22.99) <i>A minister's down-to-earth rules.</i>	14	15	
10	SWIMMING ACROSS Andrew S. Grove (Warner • \$26.95) <i>Intel's chief on his youth in Hungary and escape to the U.S.</i>	10	2	
11	JESUS, CEO Laurie Beth Jones (Hyperion • \$17.95) <i>Applying the teachings of the New Testament to business problems.</i>	--	10	
12	HOW TO BECOME CEO Jeffrey J. Fox (Hyperion • \$15.95) <i>Succinct rules for getting ahead.</i>	--	7	
13	THE POWER OF FOCUS Jack Canfield, Mark Victor Hansen, Les Hewitt (Health Communications • \$24) <i>Recipes for success, from the guys who cooked up the "Chicken Soup" series.</i>	--	1	
14	THE 21 INDISPENSABLE QUALITIES OF A LEADER John C. Maxwell (Thomas Nelson • \$17.99) <i>Changing "from the inside out."</i>	--	4	
15	THE ONE MINUTE MANAGER Kenneth Blanchard, Spencer Johnson (Morrow • \$20) <i>Getting results—from happy employees.</i>	--	1	

PAPERBACK BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST
1	RICH DAD, POOR DAD Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$15.95) <i>Teach your kids the rules of money that the rich play by.</i>	1		
2	THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Fireside • \$14) <i>Habitually popular.</i>	2		
3	THE 9 STEPS TO FINANCIAL FREEDOM Suze Orman (Three Rivers • \$13.95) <i>Learn to save.</i>	9		
4	J.K. LASSER'S YOUR INCOME TAX 2002 J.K. Lasser Institute (Wiley • \$16.95) <i>Get out your 1099s and W-2s.</i>	8		
5	RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95) <i>Move from job security to independence.</i>	6		
6	THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$7.99) <i>The simple ways of the wealthy among us.</i>	5		
7	THE LEXUS AND THE OLIVE TREE Thomas L. Friedman (Anchor Books • \$15) <i>Globalization and its discontents.</i>	11		
8	REAL ESTATE RICHES Dolf De Roos (Warner • \$17.95) <i>Why buildings beat stocks.</i>	4		
9	THE ONE MINUTE MANAGER Kenneth Blanchard, Spencer Johnson (Berkley • \$12.95) <i>Management techniques in story form.</i>	3		
10	RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$19.95) <i>Becoming rich, not merely comfortable.</i>	13		
11	WHAT COLOR IS YOUR PARACHUTE? Richard Nelson Bolles (Ten Speed • \$16.95) <i>The 2002 edition of the enduring job-search bible.</i>	--		
12	WHEN GENIUS FAILED Roger Lowenstein (Random House • \$14.95) <i>Inside hedge fund Long-Term Capital Management.</i>	15		
13	THE MILLIONAIRE MIND Thomas J. Stanley (Andrews McMeel • \$16.95) <i>The values of the wealthy revealed.</i>	--		
14	GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$14) <i>A Harvard team's step-by-step guide to conflict resolution.</i>	7		
15	I'M RETIRING, NOW WHAT?! Hope Egan, Barbara Wagner (Silver Lining • \$14.95) <i>Advice for the golden years.</i>	--		

BusinessWeek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, sales and marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based on a weighted analysis of unit sales in December.

Reviews and more are available on AOL (Keyword: bw) or www.businessweek.com

HOT TYPE IN HIS ENTERTAINING HISTORY OF BEST-seller lists, *Making the List* (Barnes & Noble Books, \$20), Michael Korda opines that there's a certain sameness about the books that succeed. Look at business titles, and you'll see what he means. The 1906 food-industry exposé *The Jungle* bears similarities to 2001's *Fast Food Nation*. The 1995 book *Jesus, CEO*, reappearing on the BusinessWeek list this month, echoes 1925's *The Man Nobody Knows*. 2001's *Real Estate Riches* brings to mind 1979's *How*

to Become Financially Independent by Investing in Real Estate. And of course 1984's *Iacocca* set the pattern for fat-vance CEO memoirs followed by Donald Trump, Sam Walton, Sumner Redstone, and Jack Welch.

Korda also shows that although the lists have many "clunkers," there have always been plenty of "good books," while brand-name writers tend to dominate more and more over time, the lists are still full of surprises.

BY KARIN PEKARC

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BY ROBERT KUTTNER

ENRON: A POWERFUL BLOW TO MARKET FUNDAMENTALISTS



BULLY:
The Enron and Long-Term Capital scandals differ. LTCM ran beneath everyone's radar. Enron worked to take out the radar stations

The deepening Enron Corp. scandal should hose away an entire world view about how capitalism is supposed to work. But will the right lessons be drawn? As a political scandal, Enron threatens the Bush Administration. No corporation was closer to the Bush family and its Republican allies. No corporation was more political in gaming the system to get the rules written in its favor. The White House damage-control machinery contends that if the President did not try to rescue Enron on the way down, his hands are clean. The real scandal, of course, is how the GOP and its broader world view helped Enron rig the rules on the way up.

The deeper scandal here is ideological. Enron epitomized an entire philosophy about the supposed self-cleansing nature of markets. Republicans are the more devout practitioners of this ideology, but both parties are implicated.

Enron, as a trading enterprise, claimed to be the quintessence of a pure free market. In practice, it was up to its ears in cronyism, influence-peddling, rigging the rules to favor insiders, and undermining the transparency on which efficient markets depend. Transparency, in turn, demands regulation in the public interest.

There is no getting around the need for regulation, since capitalism itself requires rules that govern everything from rights to financial and intellectual property to constraints on opportunistic practices that undermine the efficiency of a market system. If you think capitalism can operate in the absence of vigorous, competent, and public-minded government, look at Moscow or Buenos Aires. And government requires politics not corrupted by bribery. For it is democratic politics that elects the officials who make and enforce efficient rules—or don't.

But for three decades now, the dominant strain of economics from the University of Chicago has been teaching gullible undergraduates and journalists that there is no such thing as the public interest. Efficient outcomes are just the aggregation of selfish private interests, and government's main job is to get out of the way. Well, after Enron, these theorists should learn some other useful trade.

Even conservatives who reject other forms of government intervention grudgingly concede the need for a Securities & Exchange Commission. Entrepreneurs and traders are not saints. Deregulation is no cure-all, because decisions about which rules to waive are every bit as politicized as the decisions to regulate. We've seen the corruption of deregulation in every im-

perfect-market realm from electricity to banking to copyright law to airlines, hospitals, and telecom. None of these is an absolutely efficient market; each one requires rules. And in all these realms, whether they are regulated or deregulated, corporations seek to game the system and rig the rules.

But Enron took the prize. It not only cooked its books. It used its extensive political influence to cook the regulatory system itself. When a public-minded chairman of the Federal Energy Regulatory Commission stood in Enron's way, Chairman Kenneth L. Lay paid a call and the funder disappeared. Wendy Gramm went from being head of the Commodity Futures Trading Commission under Bush I to the Enron board. Her husband, Senator Phil Gramm (R-Tex.), helped ensure legislation allowing Enron to evade regulation either from the CFTC or the SEC.

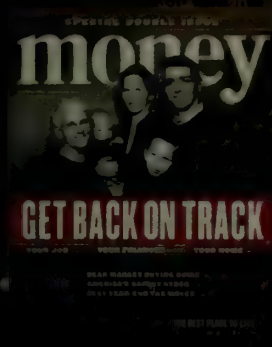
At the SEC, Arthur Levitt spent eight years trying to toughen regulation so that corporations would keep honest books and auditors would not also be retained as business strategists and spin-doctors. For this public service to capitalism, Levitt was widely vilified. His successor, Harvey Pitt, came directly from lobbying the accounting firms who were against Levitt's proposed rules.

The difference between the Enron scandal and the superficially similar Long-Term Capital Management affair is that LTCM essentially ran beneath everyone's radar. Enron, by contrast, worked to take out the radar stations. The Houston company systematically used ample political connections to rig the rules—trading, audits, disclosure, and the mechanics of energy markets. The other difference is that LTCM's dupes were ostensibly sophisticated investing adults. In the Enron case, a lot of innocent people got badly hurt.

None of this is new—only the particulars are different. The last time we learned the lesson that capitalism is not self-regulating was during the Great Depression that was followed by the reformist Democratic Administration. This time there are no catastrophic wider effects (yet) and the incumbent Republican Administration still champions the ideology of laissez-faire and the politics of cronyism. But Enron is to the menace of market fundamentalism what September 11 was to the peril of global terrorism. A very costly wake-up call. Our political leadership should pay as much attention to this assault on the very heart of capitalism as they paid to the other one.

Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale*.

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7:47	119	STAMFORD	MOUNT VERNON - 1ST STOP
8:53	123	NEW CANAAN	RYE - 1ST STOP
9:00	119	HARRISON	MOUNT VERNON - 1ST STOP
9:16	120	NEW HAVEN	GREENWICH - 1ST STOP

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EDITED BY MICHAEL J. MANDEL

AT LAST, RESPECT FOR THE EURO?

It may gain as the U.S. stumbles

Euro-zone companies and investors have spent more than \$450 billion making acquisitions or buying bonds and equities in the U.S. over the past three years. That huge flow of funds across the Atlantic largely explains why the euro has lost more than 20% of its value against the dollar since its launch on Jan.



1, 1999. But in recent months, the trend has been reversed (chart). Money is now being switched back into Old World assets, suggesting the euro may finally make up some lost ground this year.

Starting in July, 2001, the six-month average of portfolio investments into Europe turned positive and has continued to rise since then. This includes equities, bonds, and money-market investment. More than \$90 billion net moved from abroad into euro zone equities in the five months from July through November, 2001, according to London-based HSBC Bank PLC. And while euro-zone institutions are still net purchasers of U.S. fixed-income securities, that could soon change, too. European companies increasingly prefer to issue bonds rather than borrow money from their banks, and could attract more money from abroad. Also, euro-zone governments are running up bigger budget deficits that will need financing. Adding to the euro zone's allure: Short-term interest rates there are substantially higher than in the U.S.

According to Robert Prior-Wandesforde, HSBC's European economist, money is moving back into the euro zone because investors on both sides of the pond are skeptical that the U.S. downturn is over. "If the U.S. economy real-

ly has bottomed, the 2001 recession would be one of the shortest and mildest on record," he says. Moreover, Prior-Wandesforde doubts that euro zone companies will embark on another big U.S. spending spree so long as the country is suffering from major overcapacity.

Credit Suisse First Boston Corp. chief economist Giles Keating now predicts the euro will appreciate by up to 10% in 2002 after a lackluster start to the year. Such a rise for the sickly single currency would be good news after its bad beginning and attract even more foreign investors to Europe.

By David Fairlamb

NO DOCTOR IN THE HOUSE

The shortage will only get worse

Having trouble finding a doctor? A study points out that the U.S. has fewer physicians per dollar of gross domestic product than most countries in the Organization for Economic Cooperation & Development. Moreover, the study, which was published in the January/February, 2002, issue of *Health Affairs*, a well-respected policy journal, argues that the U.S. is likely to face an increasingly serious shortage of physicians over the next two decades.

That's far different from the conventional wisdom, which is based on earlier reports commissioned in the 1990s by the Council on Graduate Medical Education. These studies had forecast a surplus of physicians, based on the predicted demand for physician visits and procedures.

But the authors of the latest study—Richard A. Cooper, Prakash Laud, and Heather J. McKee at the Health Policy Institute of the Medical College of Wisconsin and Thomas E. Getzen at Temple University—point out that the demand for medical services over the past 70 years has grown 50% faster than GDP. Taking into account the number of medical school graduates, the number of foreign doctors, and the ongoing substitution of nurse practitioners, physicians' assistants, and nurse-midwives for physicians, they calculate that the U.S. will have a shortage of 50,000 physicians in 2010. If these trends continue, the shortage will rise to 200,000 in 2020, more than 20% of total demand.

Of course, it could turn out that the U.S. manages to slow down increases in health-care spending, despite rising GDP.

That could reduce the demand for physicians. But given the recent history of rising health-care costs, such a scenario doesn't seem likely.

By Margaret F.

BANKRUPTCIES—NOT OVER YET

Personal filings may peak in the

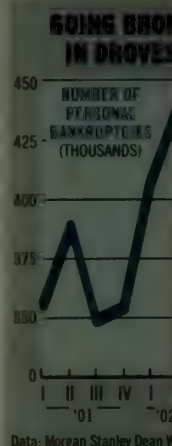
The consensus among economic forecasters is that the economy is bottoming out. Nevertheless, personal bankruptcies will continue to rise through the third quarter of 2002, according to a report from Morgan Stanley Dean Witter & Co.

The number of bankruptcies followed roughly the same path as unemployment, observes Kenneth Posner, senior credit analyst at Morgan Stanley and author of the study. "If people are losing jobs, they'll have much greater difficulty in keeping up with their bills," he says. The firm expects unemployment to peak at around 6.5% in the third quarter. Bankruptcies should probably top out the following quarter at about 450,000 or so, a 29% increase over the third quarter of 2001 (chart).

In some ways, this would not be as bad as previous downturns. From peak to the trough of the past six business cycles, bankruptcies climbed 60%, according to Posner. This time, estimates, they may rise only 50%. Indeed, there's some evidence outside of auto loans, consumer credit, and taking on debt at a slower rate, a fair proxy for credit card debt, grew only 5% in November 2001, compared with a year earlier. That's far slower than its 12% growth at the end of 2000.

Nevertheless, banks may continue to be too generous with consumer credit. "Big credit-card companies are still mailing out millions of promotional credit-card offers with favorable interest rates," Posner says. These credit-card offers could backfire as more people lose their jobs, driving the bankruptcy rate even higher than expected.

By Margaret Popper



JAMES C. COOPER & KATHLEEN MADIGAN

WILL THERE BE A SECOND DIP IN THE RECESSION?

Don't worry about it: Consumers won't let that happen

U.S. ECONOMY

The Commerce Dept.'s Jan. 30 report on real gross domestic product will most likely show that the U.S. economy contracted at an annual rate in the neighborhood of 1% in the fourth quarter despite a surge in real consumer spending of about 4%. Since a lot of that boost came from an unsustainable jump in car buying, a fall-back in consumer outlays is occurring this quarter. Will the drop be a one-shot deal or could a continued consumer retrenchment extend this recession?

FAITH IN THE FUTURE IS LIFTING SPIRITS



But don't worry. Consumers are not going to lead the U.S. into a double-dip recession or prevent a recovery from taking hold. Certainly, there are risks, but the favorable fundamentals underlying spending argue that households will remain resilient in 2002. The double-dip scenario goes like this: After dropping in the final two quarters of 2001, real gross domestic product will manage a gain this quarter, thanks to inventory rebuilding. But further weakness in consumer spending will cause the economy to relapse. Consumers will be cowed for several reasons. First, lucrative incentives stole car sales from 2001. Second, labor markets and wage growth will be weakened further. Third, two recent props under consumer spending will fall away: mortgage refinancings and cheaper energy. And last, with savings low, consumers will be crushed by their debt loads.

THESE WORRIES, HOWEVER, don't tell the whole story. Households have, for the most part, shrugged off terrorism, layoff announcements, and the scandal at Enron Corp. Optimism is the highest in a year (chart), and consumers keep shopping. True, the reversal in car buying will affect first-quarter data. Vehicle sales, which averaged a record 18.4 million annual rate in the fourth quarter, may not top 15 million this quarter. That decline will probably cause overall consumer spending to post the first quarterly drop in a decade. But households are buying more than just cars. Retail sales excluding cars and gasoline rose from October through December (chart). Discounting moved much of the merchandise, but the steady uptrend shows that consumers are willing to shop, especially for house-

hold-related goods. December sales at furniture and electronic stores were up nearly 10% from a year ago.

The second double-dip worry—further deterioration of the job market—is always a risk for consumers. But falling weekly jobless claims strongly suggest that the worst job news is over. The consensus view of economists surveyed by Standard & Poor's MMS is that nonfarm payrolls fell by only 60,000 in January. That would be the fewest layoffs since August.

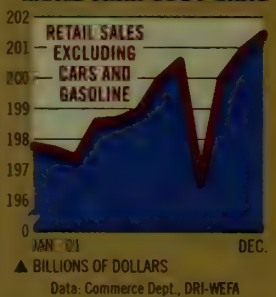
True, the increased ability of U.S. companies to generate output from productivity gains suggests that layoffs will continue after the recovery starts. But as Federal Reserve Chairman Alan Greenspan pointed out in a Jan. 11 speech, as productivity strengthens, "average real incomes could rise, at least partially offsetting losses of purchasing power that stem from diminished levels of employment." Unemployment is devastating to those directly affected, but better productivity will help to boost real pay for the 94% of the labor force that still has jobs.

Nor does the dissipation of mortgage refinancing or cheaper fuel spell disaster in 2002. Refis cut monthly payments or enable people to cash out some of the equity built up in their homes. Greenspan said the cash-outs alone totaled "roughly \$75 billion" at an annual rate in the third quarter of 2001. In addition, he estimated that lower fuel costs "added more than \$50 billion, at an annual rate, to household purchasing power in the second half of last year."

Mortgage rates and fuel costs stopped falling at the end of last year, but the windfall from both supports is still working its way through the economy. Energy prices have not risen from a year ago, so consumers can still heat their homes and fill their tanks more cheaply than in the winter of 2001. And homeowners who refinanced are still paying lower monthly mortgage costs than they used to.

INDEED, CONSUMER FINANCES are in better shape than they were in early 2001. A major misconception in recent years is that sinking stock prices, crushing debt burdens, and skimpy savings have robbed many households of any ability to cope with the down-

CONSUMERS ARE BUYING MORE THAN JUST CARS



draft of a recession. But that's overstating the case.

To be sure, eroding stock wealth is still taking a toll on consumer spending, and the impact will continue this year. Only about a third of households, however, own stock directly, while more than two-thirds own their homes. Since the first quarter of 2000, the value of corporate stocks and mutual funds directly held by households has declined by \$4.8 trillion, based on Fed data on household balance sheets. But at the same time, house values have risen \$1.8 trillion, while mortgage debt increased by \$700 billion. That gave homeowners a \$1.1 trillion net gain in the value of most consumers' biggest asset—a nice offset to any stock losses (chart).

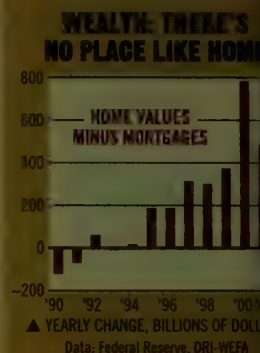
The recent performance of property values is in sharp contrast to the previous recession. During 1990 and 1991, housing net worth fell \$200 billion. Homebuilding activity will contribute little to the coming recovery because it didn't fall off during the recession. However, housing's more important contribution may well be its lift to household balance sheets.

CONSUMERS HAVE ALSO taken advantage of low interest rates to manage their debt burdens. In fact, revolving installment debt peaked in June, and the decline since then is a record. Households are using tax refunds and lower financing costs to pay down their debts. Debt-service payments for nonmortgage debt fell in the third quarter, the first drop in a decade.

No doubt some households are hurting financially right now. Delinquency rates for auto loans, personal loans, bank-card debt, and home mortgages all are from a year ago. This, however, is typical recession behavior, suggesting no unusual structural problem.

Finally, the problem of low household savings is overblown. The Commerce Dept. defines savings as income that is not spent. Except for the boost generated by the tax rebates, the saving rate held at a puny 1% last year, down sharply from about 8% in 1990. But income from realized capital gains, a growing source of cash in the past decade, is not included in that measure. If it were, some economists have estimated the current saving rate is upwards of 10%, down little from about 10% in 1990. That level of savings should provide a healthy cushion for consumers.

Certainly, dangers remain in the consumer outlook. The uncertainty of terrorism, the spillover effects of bankruptcies at Enron Corp. and Kmart Corp., and another stock-market swoon are potential pitfalls. But in 2001, U.S. consumers were resilient despite great obstacles. Nothing suggests they will cut back in 2002.



ITALY

REPORTS OF A RECOVERY MAY BE EXAGGERATED

The Italian government has declared the recovery is under way. But the recent disastrous news from the industrial sector calls such optimism into question.

In mid-January, Prime Minister Silvio Berlusconi said the recovery had already begun. The government is forecasting real gross domestic product will grow by 2.3% for 2002, after an estimated advance of 1.8% for 2001. But the Organization for Economic Cooperation & Development projects only 1.2% growth, a lower figure echoed by private economists.

Certainly, the latest data are disappointing. Industrial output plunged by 2.6% in November, the biggest drop in nine years (chart).

Capital-goods makers cut their production by a steep 3.7%, in part because foreign demand for machinery and parts has sagged because of the global slowdown.

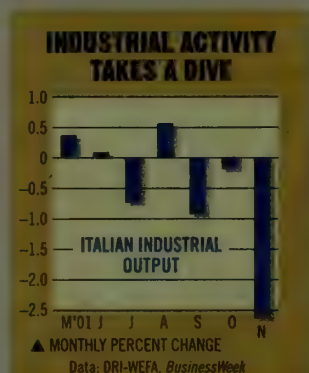
Businesses are more pessimistic about the outlook. In November, the index of business confidence slipped back to 83, a 5½-year low.

Consumers, meanwhile, are not as gloomy. Confidence among Italian households was at a high 124 in November. Labor-market reforms are improving the job situation. The jobless rate reached a record low 9.2% in October. Plus, lower fuel costs are also increasing household buying power.

Even so, real consumer spend-

ing is on track to remain flat in the fourth quarter. And with business spending down, real GDP probably contracted by a 1% annual rate. First-quarter real GDP could also fall by that amount, since foreign demand is still weak.

Lower growth could mean that Berlusconi's government misses its budget deficit targets. Rome estimates that the deficit equaled 1.1% of GDP in 2001, and its goal is to have the budget in balance by 2003. To that end, it has extended a one-shot tax-amnesty plan. But the government still needs to reform the pension program in order to make any fundamental changes to Italy's fiscal problems. So far, the reforms have been minor—probably because officials know that attempts at pension reforms toppled the first Berlusconi Administration, in 1994.

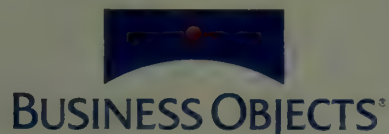


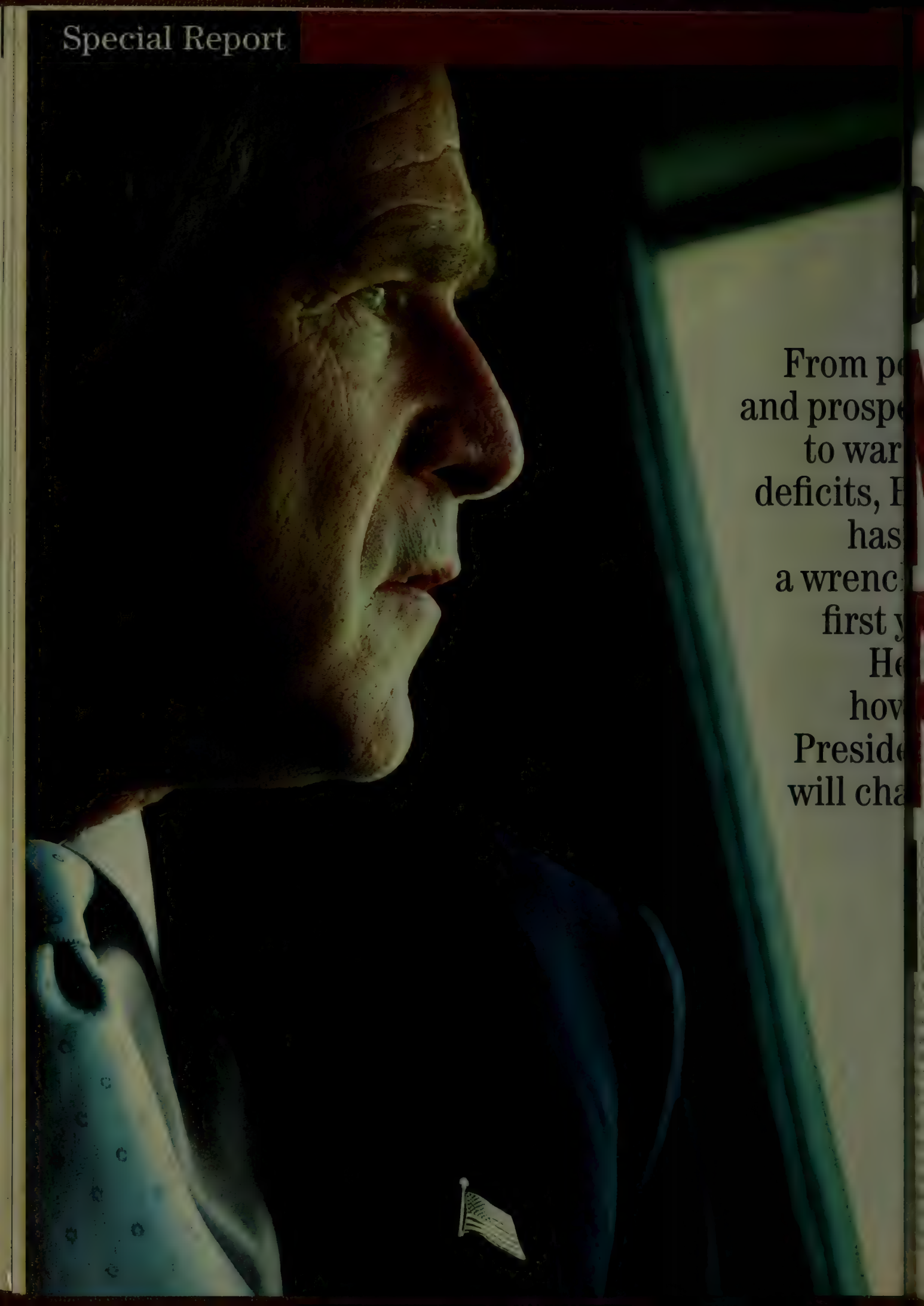


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BUSH'S NEW REALITY

BY LEE WALCZAK

If Bill Clinton was the ultimate political improviser, George W. Bush has been his polar opposite: a devotee of meticulous planning and a Presidential style that leaves little to chance. Beginning with an intensive series of 1999 policy tutorials in Austin, the then-Texas Governor crafted a platform that, to his mind, seemed perfectly attuned to the times. He backed an insular foreign policy aimed at disentangling the U.S. from messy nation-building missions. On the domestic front, he planned to tap billions in boom-time surpluses for sweeping cuts and a "compassionate conservative" agenda that offered generous new aid for the working poor. So much for forward planning. Outside of the tax front, where the new President won a resounding victory with passage of a \$1.35 trillion tax cut, little has gone according to script. The defection of a maverick Vermonter tilted the Senate to the Democrats, forcing Bush to make concessions to the opposition. Terrorist attacks on New York and the Pentagon ended the Administration's global detachment, replacing it with a high-tech war on terror, frantic coalition-building, peacekeeping missions in red-hot spots, and lots of foreign aid. Meanwhile, the abrupt halt to the 10-year economic boom stuffed out the revenue gusher Bush had counted on to pay for compassionate social spending and conservative tax cuts.

Deepened by the economy's post-September 11 swoon, the downturn burned a hole through the budget even as it became clear that national security outlays would have to rise for the foreseeable future.

On top of those blows to the economy and investing came the collapse of Enron Corp. Its saga—replete with tales of creative accounting, insider dealing, and a web of political influence that reached far into both Republican and Democratic circles—is compelling a deregulation-minded White House to rush out new controls on the financial sector.

The shift from peace and prosperity to open-ended war and deficits represents one of the most wrenching turnabouts for any recent President. While Bush's commitment to conservative principles remains unswerving, the Right's antennae are twitching. Says David A. Keene, chairman of the American Conservative Union: "Bush walks a fine line. He wants smaller, less intrusive government but is now presiding over a government that's big and growing."

True, but it's mainly growing in a relatively narrow sector: military spending and a new rapid-response system to deal with terrorist attacks. In the President's 2003 budget, scheduled to be released on Feb. 4, the Pentagon and new Office of Homeland Security will get \$64 billion in new budget authority. But because Bush wants all appropriations to rise less

WHITE HOUSE PHOTO BY ERIC DRAPER

The Afghan victory won't help Republican incumbents

than 5%, other programs will be squeezed hard, setting up battles with congressional Democrats and Republicans alike.

These altered priorities represent a big shift from Bush's original, bountiful "tax-cut and spend" vision, and they are a key reason the President needs to think about a new agenda. The other reason is his substantial record of first-year accomplishments. The leader whose legitimacy was once in doubt has done an immensely skillful job of getting his core policies in place. Taking office amid the fog of the disputed Florida vote, he managed wins on many of his "big reforms": a 10-year cut in marginal tax rates, a plan to boost school performance, and—because of the war—a big downpayment on military modernization. Only Social Security investment accounts and a "faith-based" anti-poverty initiative, always the most problematic items on his A-list, eluded him.

A President's fruitful first year often marks the apogee of his power, though, and now Bush faces a stark new world. It is marked by the rising unemployment that's a hallmark of the New Economy bust, projections of future deficits, post-Enron pressure for re-regulation, angst over health-care costs, and alarming poverty statistics. But unlike Clinton, who riffed his way through office, moving fluidly from advocacy of a national health system to welfare reform, Bush is hemmed in by his desire for constancy. He thinks of himself as the anti-Clinton and meant to replace Bill's jam-session jazz with the predictable cadence of a country-and-western tune.

For Bush, the dizzying pace of change poses both a challenge and an opportunity. And it's the reason lights at the White House are burning into the night as aides labor over his Jan. 29 State of the Union speech. It must deftly touch on the Administration's sure-footed performance in the anti-terror war—which is behind Bush's 83% approval rating—while signaling a shift to domestic matters and the sickly economy.

While the lightning Afghan campaign was a tonic for Republicans, party officials know that battle ribbons won't be much help for GOP incumbents in November if the recovery is anemic. "This is becoming a Bush economy," says Thayer Capital Partners Chairman Frederic V. Malek, a longtime family friend. "I would like to see more of a push for stimulus from the [President's] economic team, because we need it."

Indeed, as the focus on the economy grows, Bush, now basking in a Churchillian glow, will face traditional hazards that bedevil leaders consumed by the demands of war. "Bush is entering a minefield period," says Fred I. Greenstein, a Princeton University Presidential scholar. The economy "is an area where there is a gap between his rhetoric and reality."

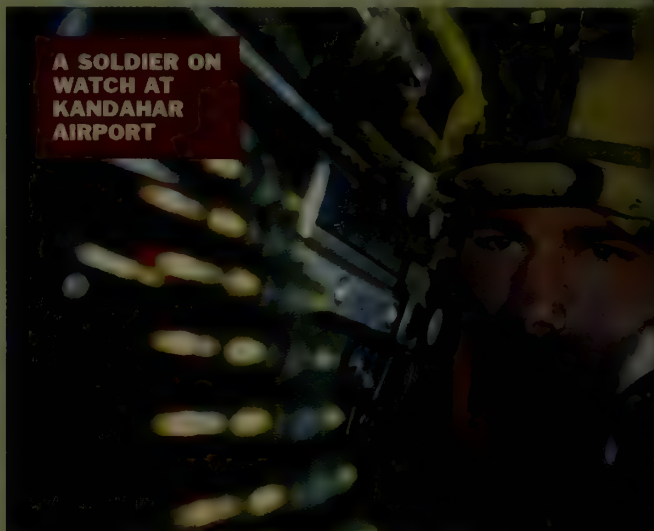
In his address, the President will attempt to link his stellar showing on the national-security front to another war

that has to be won: vanquishing the recession and getting growth rates into the 3% range. To Bush's conservative economic advisers (page 32), that requires the removal of one calls "roadblocks to growth"—government waste, regulatory barriers to small business and the Internet economy, high litigation costs, and a complex and inefficient tax code also means curbing the country's reliance on foreign oil.

Bush's political advisers, led by White House counsel Karl Rove, have more immediate concerns. To limit a backslide over the economic slump, the Administration will bundle leftover stimulus ideas into a rechristened "economic security program." In West Virginia on Jan. 22, Bush set the stage by urging Congress to "keep in mind one word—jobs."

Hits, Misses, And Moving Targets

Data: BusinessWeek



ACCOMPLISHMENTS

WAR ON TERROR September 11 gave Bush's Presidency an overarching mission. It also boosted efforts to modernize the military and deploy Star Wars.

BIG TAX CUT Read his lips—he meant it. The hard-fought \$1.35 trillion tax cut is his signature domestic achievement.

EDUCATION REFORM In this key victory, the President showed he can cut deals with Dems when it suits him.

The key elements of "economic security" are accelerated tax cuts, extended unemployment benefits, tax breaks for purchasing health insurance, and a dollop of more money for working moms and inner-city youths. Political pros view this kind of repackaging amid budgetary stringency as "tactical compassion." Says University of Texas political scientist Bruce Buchanan: "This is a rhetorical rather than substantial exercise. There's no way Bush can get to the left of Democrats [on aiding recession victims]. But as was the case with prescription drugs, he'll just throw a plan out there."

Although the aid is far less than Democrats desire, White House hopes its economic security blanket signals that compassionate policies will continue. "Bush may not read the polls, but his advisers sure do," says the Atlantic City's Keene. "At a time of anxiety over jobs and personal safety, it's smart to use a powerful term like 'security.' But from a conservative's standpoint, it's also a bit dangerous. You're speaking the language of the opposition."

November if the economic recovery is anemic

Actually, Bush's biggest problem isn't resistance from conservatives who fear that individual freedoms will be sacrificed in the sake of fighting terrorism and recession. More worrisome are mainstream voters who might not discern much of a safety net behind the President's economic pep talks. "Republicans need a lunch box economic theory that goes beyond tax cuts," says Bruce Reed, president of the Democratic Leadership Council. "It's an interesting challenge to show you care when you don't want to lift a finger."

Bush, of course, plans to do quite a bit more than that, but is burdened by a lack of resources and the impression that he accepts new social spending only as a bargaining chip for his all-powerful tax cuts. Beyond that, most political ex-

campaign media adviser: "The war and recession—and clearly, it is not a 'Bush recession'—mean that dollars are now very limited. If not a lot gets done this year, the war becomes a filter for everything."

That's not to say the Administration won't try to move the ball on Capitol Hill with a program of carryover items, such as a patients' rights bill, and a few new overtures. Says one business lobbyist: "Karl Rove's plan is to keep the pipeline full so the President can dominate the agenda. A lot of these secondary items, like patients' rights, don't cost very much. So we're back to the old Clinton idea: 'I share your pain.'"

While the White House has not finalized ideas for Bush's Jan. 29 speech, here's a glimpse of the evolving agenda:

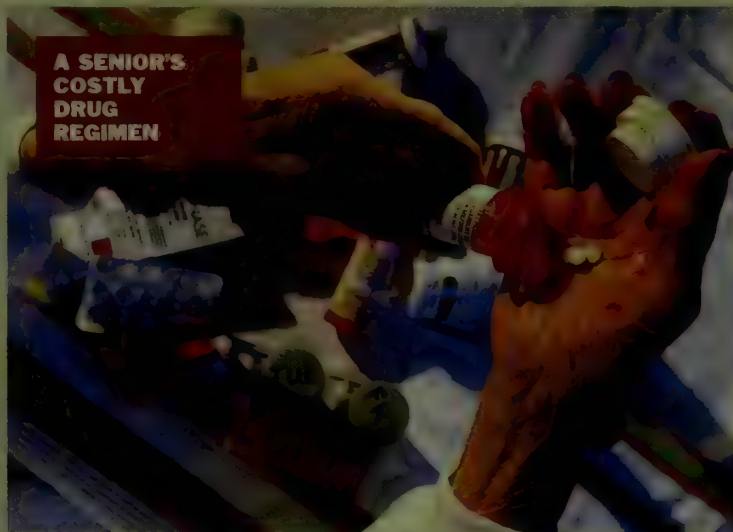


UNFINISHED BUSINESS

ing a patients' bill of rights.
oration of fast-track trade-negotiating authority.
ting parts of the stalled stimulus package.
ing a national energy plan in place.
promise on a scaled-back "faith-based initiative."
antanteeing terrorism insurance for business.

arts think that, stylistically at least, the President who refers to extol personal responsibility has little choice but to tell Americans that government will fight the downturn. It's a lesson seared into his consciousness by Bush Sr.'s fall from grace after the glory of the Persian Gulf War. "The public has seen concrete evidence of concern," says a GOP consultant. "If you have to say, 'Message: I care,' they know you don't." Despite Bush's aggressive effort to inoculate himself from the Enron scandal, Democrats hope to make the midterm elections a referendum on budget deficits and Bush's blindness to corporate abuses. But political experts doubt that an attack based on bemoaning budgetary red ink will move many voters. And Democrats' links to Enron's political piggybank undermine charges of a GOP scandal.

"Bush has faced cataclysmic changes," says Brown University political scientist Darrell West, "but there's an upside." For instance, the President can now "blame his budget and economic woes on Osama bin Laden." Adds Mark McKinnon, Bush's



PROBABLY GOING NOWHERE

- ▶ Private Social Security accounts.
- ▶ Medicare overhaul and new drug benefit for seniors.
- ▶ Big tax breaks for corporations.
- ▶ Aggressive rollback of regulations.
- ▶ Large-scale tort reform.

HELP FOR WORKERS: Bush plans to put just under \$100 billion in the budget for stimulus, but aides fear that Senate Majority Leader Tom Daschle's latest offer of a slimmed-down package is a ploy. In that case, Bush will try for piecemeal passage of key items, such as extended unemployment benefits and money to help buy health insurance.

Prospects: Chances for a modest economic security package look good.

FAST TRACK: Building on last year's House passage of legislation restoring the President's ability to speed trade pacts through Congress, the White House will push to get enough moderate Senate Democrats on board to break the deadlock. Compromise language that pays more heed to labor and environmental protections is pivotal.

Prospects: Decent. U.S. Trade Representative Robert B. Zoellick is in dealing mode, and House GOP hardliners may go along.

Investors and retirees are likely to get new protections

ENERGY: On the energy front, Bush and Vice-President Dick Cheney are trying to dislodge a comprehensive bill from the Senate and are using the argument that it's really a jobs program. Under the leadership of Energy Committee Chairman Jeff Bingaman (D-N.M.), Democrats have already added conservation incentives to the pro-production Cheney plan. The hangup is drilling in the Arctic National Wildlife Refuge. Moderate Republicans warn that the fight isn't worth

ing co-payments and deductibles, interest in patient protection is running high. The big sticking point on the health front is the promised Medicare prescription-drug benefit for seniors. Bush campaigned on a \$150 billion plan that many experts say understates the cost of the new entitlement. Later this year, Iowa Senator Charles E. Grassley, top Republican on the Senate Finance Committee, will introduce something a little more realistic. The price tag: \$300 billion. There's just one problem, says Grassley: "I don't see where we get \$300 billion."

The Administration will insist that with Medicare cost controls, the government may be able to afford prescription drug subsidies. Dems are set to go on the attack, charging the elusive benefit is another example of Bush tax cut crowding out social spending. "The demagogue us on the issue and insist it's another case of our policies being tilted to the rich," says GOP demographer John Morgan.

Prospects: Good for patients' rights, bleak for drug benefit—though both parties will push through the motions.

BUSINESS TAX BREAKS: Corporate America's plan to use the stimulus package as a vehicle for tax breaks such as accelerated depreciation and relief from the alternative minimum tax fizzled with the demise of the House GOP. "Frankly," says one lobbyist, "the corporate guys overreached with AMT and managed to look like hogs at the trough." Now, business reps talk glumly of just extending the life of research-and-development tax credit and other expiring business incentives.

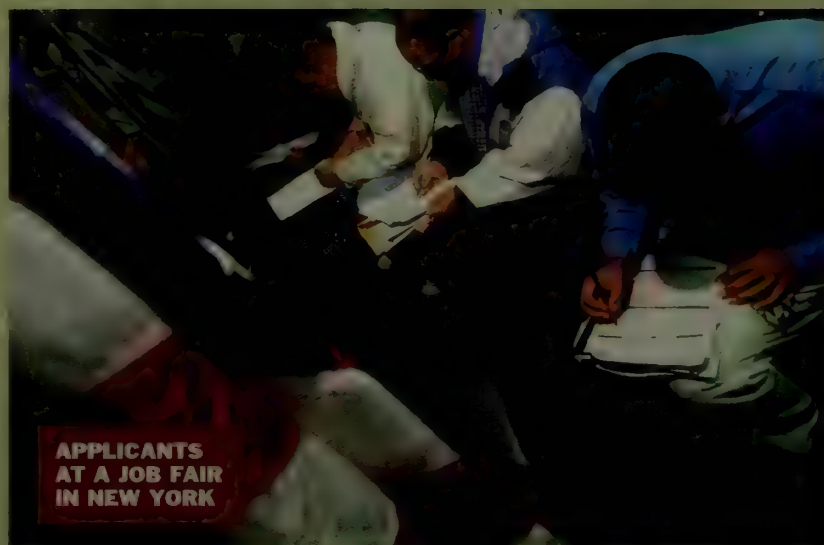
Prospects: A few small breaks pass this year, when it comes to generous corporate tax relief, the train has left the station—and nobody was aboard.

TAX SIMPLIFICATION: Although corporations may be left empty-handed, that doesn't mean Bush is through tinkering with the code. The Treasury Dept. has given the White House options for what could turn into a major study of tax simplification. By 2004, the proposal could form the basis of a reelection issue—overhaul to make taxes "fairer and flatter." That would be music to conservatives' ears since they want Bush to commit to still-lower rates and whack at the capital-gains tax. Says Treasury Secretary Paul H. O'Neill: "We [first] need to work on simplification [ideas] that are within our control while we're thinking about something bigger."

Prospects: Republicans don't tend to run for office without brandishing a tax cut, so Bush may rev up the tax-reform issue at reelection time.

MORE SCHOOL REFORM: The Administration is planning a vigorous follow-on effort to this year's education reform bill. The President plans to put an additional \$1 billion in the budget for inner-city school districts and special-ed programs. Aides say he will keep barnstorming

New Directions



APPLICANTS
AT A JOB FAIR
IN NEW YORK

"ECONOMIC SECURITY" FOR WORKERS Key elements: extended unemployment benefits; tax credits for health insurance; education and training for those who lose jobs due to foreign competition; and a little more money for the Job Corps and working moms.

NATIONAL SECURITY The Pentagon gets up to \$48 billion in spending authority; \$16 billion goes to the Office of Homeland Security.

SIMPLIFYING TAXES Treasury is studying ways to simplify the tax code and broaden the revenue base.

HEALTH CARE Bush aides dream of replacing the current system, run by government and employers, with one that is largely employee-financed.

BROADBAND DREAMS Techies are pressing the Administration to make universal access to high-speed Internet connections a priority and to provide federal incentives.

MORE HOMEWORK The Prez plans to follow up this year's school reforms with a continuous stress on education. His 2003 budget adds \$2 billion for poor districts and special ed.

it, but Bush thinks he has enough labor support to prevail.

Prospects: Compromise legislation should pass this year.

HEALTH CARE: Administration officials desperately want an accord with the Democrats on a patients' bill of rights now that lawmakers have bowed to White House demands that make it harder to win big judgments against insurance companies. With both parties concerned about angry consumers hit by ris-

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The Enron scandal has put the kibosh on Administration

the country, talking up the need for more improvements. **Prospects:** Very Clintonesque. Bush will back targeted education aid each year to spotlight his commitment to a national literacy program.

SOCIAL SECURITY: The recession and the return of deficits have doomed Bush's call for private investment accounts. Nervous GOP incumbents have told the White House to clam up on the subject until after the midterm elections. To complicate matters, gross domestic product would have to bounce back to boom levels before the idea could be viable again since Bush blew the estimated \$1 trillion transition cost of a semi-private retirement system on his tax cut.

Prospects: The President will revisit the idea of modest investment accounts in 2003. Sooner or later—make that much later—the idea will probably become a reality.

REGULATORY REFORM: The Enron debacle has put the

kibosh on plans for large-scale legislative deregulation of business. The Bushies will try to do what they can via administrative action, using the Office of Management & Budget as a hit squad for costly regs. Similarly, dreams of a major overhaul of the tort law system are giving way to a less ambitious agenda. "We will try to go issue by issue," says a corporate rep, "trying for limits on the tort bar on selected pieces of legislation rather than going the big-reform route."

The Administration will soon propose some new controls over business as part of the Enron fallout. Bush is being urged to tighten corporate governance, provide investors with a more transparent flow of financial data, and limit single-stock holdings in employee 401(k) plans. "You cannot on the one hand extol the rise of the investor class and leave the impression that the game is rigged against the little guy," says one lobbyist who advises the White House. "New controls are needed to flush out the system."

Prospects: Bush may announce new investor and retiree

HARDLY A ROUT IN THE WAR ON RECESSION

The contrast could not be more striking: When it comes to waging the global campaign against terrorism, the Bush War Cabinet, led by Defense Secretary Donald H. Rumsfeld, has been as on-target as a smart bomb. But can the same be said of Bush's economic team—a seemingly leaderless bunch whose titular commander is Treasury Secretary Paul H. O'Neill?

While Bush's economic aides pushed hard for the President's \$1.35 trillion tax cut, they have been less successful battling the recession. The Administration has failed to speak with a single, reassuring voice on the slump. It was unable to muscle a stimulus package through Congress, often stepping on Capitol Hill toes. And it has sparked confusion about international economic policy by vowing to end big bailouts—then handing billions to Turkey and Argentina before saying *no más* when Argentina asked for more. Says a top outside counselor to the White House:

"The challenge for Bush in 2002 is to make the domestic and economic team look half as good as his war team was in '01."

True, the econocrew has had significant successes. Besides an enormous victory on

the tax cut, which pumped \$38 billion into a sagging economy, it helped get financial markets reopened less than a week after September 11. And it has clamped down on a web of terrorist financial networks.

The troika—Treasury's O'Neill, top White House economic aide Lawrence B. Lindsey, and Council of Economic Advisers Chairman R. Glenn Hubbard—are astute analysts and strong personalities. But no one has emerged as first among equals.

Bush's advisers defend their performance, insisting their first year has been successful. And they say many of their earlier clashes have been resolved. "The reporting about how the team works is way behind the power curve," says O'Neill, "We're coming along." Adds Lindsey: "Criticism is part of the game. We've done pretty well."

O'Neill, the former CEO of Alcoa Inc., wins high marks for coordinating the campaign against terrorist financing.

Still, he has embarrassed the Administration with blunt comments on everything from the health of the dollar to the state of Congress. Many of those remarks, such as calling an ill-fated House plan "show business," were surprisingly candid and accurate. But White House insiders and Wall Street—accustomed to obfuscation by public figures—know what to make of O'Neill. Says Michael Mussa, a former economist at the Reagan White House: "He has a talent for saying the right thing at the wrong time. In a job where what is an important part of the impact you have, it has been a problem."

Nowhere is that more true than when it comes to the dollar. On September 11, O'Neill tried to signal Treasury comfort with Japan's attempts to weaken the yen. But his comment instead convinced traders that the dollar would wink at a rising yen and dollar. O'Neill just shrugs at the criticism of his candor. "I don't know

The Economic Team: A First-Year Report Card



THE TAX CUT

A huge political victory that also pumped nearly \$40 billion into a sagging economy. But the massive long-term cost will sharply constrain Bush's future agenda.



RESPONSE TO SEPT. 11

The eco team helped get financial markets back in business in less than a week and cracked down on worldwide sources of terrorist funding.



STIMULUS PACKAGE

Turned in a hodgepodge of budgeted, ill-timed ideas and the White House could not cut through political squabbling to win passage.

s for large-scale deregulation of business

ons as soon as the State of the Union. New curbs "are
ing" from Congress, shrugs one adviser. "We might as
get ahead of the curve."

ding by the number of items on the President's to-do list,
seems intent on projecting a picture of Teddy Roosevelt-
igor, even in the face of vanishing surpluses and rising se-
obligations. "The country has always liked activists in the
e House," says GOP pollster Robert Teeter. "George W. is
ys moving, always looking for big things to do. And when
thing unexpected like Enron comes along, he says 'let's
a Republican fix' for the problem."

course, it is far from clear yet that Bush has "fixed" the
age from Enron, which continues to widen as a case study
financial collapse. And an
omy staggering under mas-
overcapacity and consumer
may not be prone to repair

g the truth," he says. "I
really offensive to people
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he has become a lightning
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akers want him dumped.
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the senior Republican on
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." "The private view is that
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to the Democrats too ear-
Grassley.

House sources, however, insist
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b is safe. What's more, the
in a recession, and there is no
choice to replace him. Also,
fects conservative criticism
n.

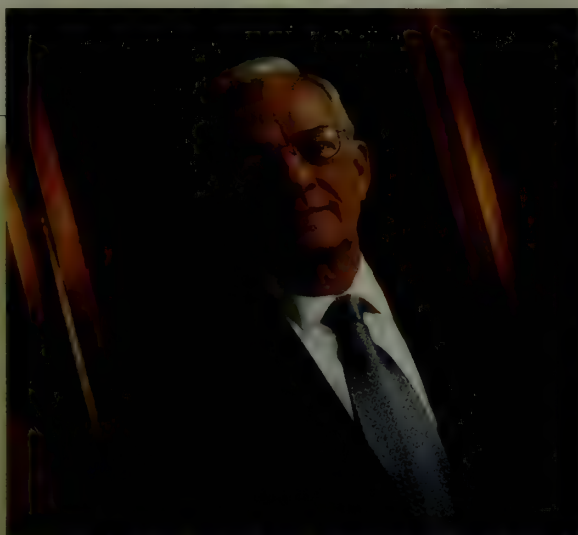
y, who was Bush's economic
or during the campaign, still
resident's ear. He's highly re-
n Wall Street and has good
ns with the world's money
But he is seen as a weak man-
because he aggressively pro-
own agenda of supply-side

with just a little splash of economic-security assistance.

Ultimately, the President who now inhabits the political
stratosphere will be judged by his economic stewardship and
ability to tackle problems that Americans care about most:
jobs, affordable health care, decent schools, and, yes, protec-
tion from terrorist bombers. Now that the New Economy
boom has given way to the sobering morning after, it's clear
that the President—still drawn to sweeping ideas—has more
will than wallet to pursue his vision.

That could present the ultimate irony for Bush, the studied
anti-Clinton. Unless growth returns to boom-time levels, he
could increasingly be forced to adopt some of his reviled prede-
cessor's favored tactics: big talk but micro-programs, horse-trad-
ing that results in the gradual disappointment of his ideological
base, and some smooth political palaver to
cover it all in a cloud of empathy.

*With Richard S. Dunham and Rich
Miller in Washington and bureau reports*



O'NEILL: "I don't know how to stop telling the truth"

been an effective public advocate.

And he lacks the clout to broker dis-
putes between the other principals.

There are compelling reasons why
the economic crew may never meas-
ure up to the national-security team.
While September 11 galvanized the
Administration and nation around a
single goal—protecting America—
there is no such focus when it comes
to the economic challenges. Says
Goldman, Sachs International Vice-
Chairman Robert D. Hormats:

"Bush is Commander-in-Chief of the
military, not the economy."

In addition, until recent days, the
President has been far more engaged in
the war than in domestic economics.
And the Pentagon has enjoyed a rela-
tively free hand, largely immune from
the pressures of both Congress and
Bush's powerful political commissars,
Carl Rove and Karen Hughes.

With the U.S. struggling with reces-
sion and rising unemployment, and
with congressional elections looming,
Bush needs to seize control of the eco-
nomic agenda if he is to maintain
strong support among voters. That
means his economic team will have to

prove that it can
be as effective
bolstering the
economy as the
Administration has
been in battling
terrorism.

*By Howard
Gleckman and
Rich Miller, with
Lee Walczak, in
Washington*

JAPAN A low-
key approach to
economic re-
apan failed as
the Clintonites
ectoring. And
efforts to sig-
measure with
cklired.



GLOBAL ECONOMICS

Mixed mes-
sages turned efforts to
reform the IMF into
a muddle. Bushies
vowed to end old-style
bailouts but backed
them anyway.



ENTITLEMENT REFORM

Handpicked
commission couldn't
find a fix for Social Se-
curity. Medicare reform
is on hold. Resurgent
deficits will stymie re-
form efforts for years.

BOTTOM LINE

The
slump was beyond
Bush's control. On bal-
ance, his policies helped
soften the blow. But he
could have pressed for
quicker action on stimu-
lus, airport security, and
terrorism insurance.

BRACING FOR A BACKLASH

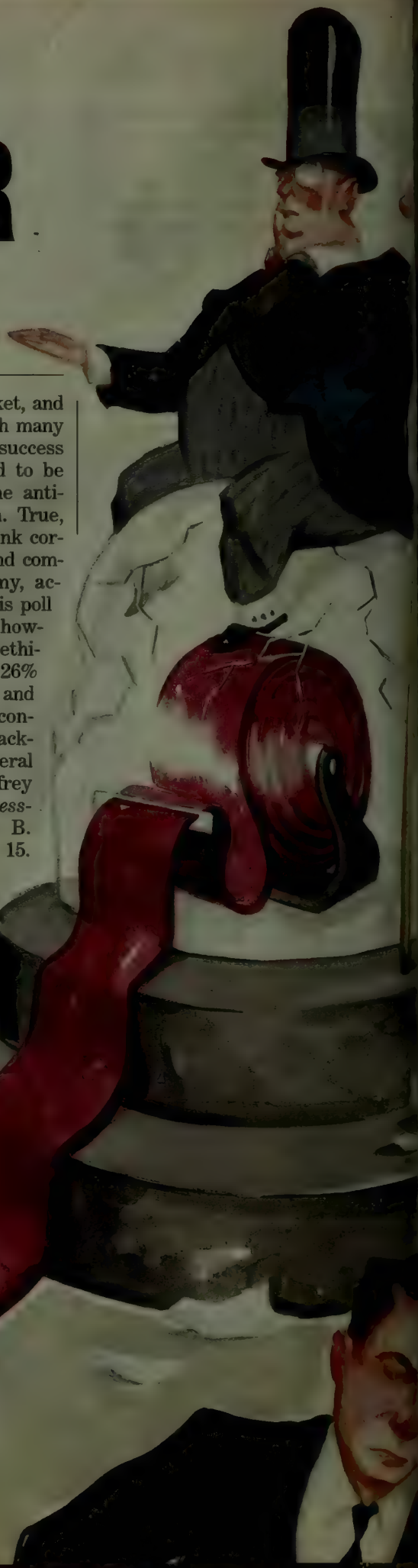
After Enron, business may be subjected to a new wave of regulation

During the 1990s boom, Americans had mixed views about the world of business. Most applauded the bounty produced by the U.S. economy, support for deregulation was on the upswing, and many rushed to grab a slice of the pie by investing in the rising stock market. For many, business simply became cool. Yet even with the bull market and the New Economy in full swing, a backlash began to build as many also grew angry at the perceived high-handedness of big corporations: the uncaring HMOs, the lousy airline and telephone service, the price-gouging drugmakers, and the sweatshops run by shoe and garment makers.

Now the Enron Corp. scandal—coming on the heels of a

sharp recession, a tumbling market, and an extended stretch during which many of the most vaunted business success stories of the late 1990s proved to be chimeras—threatens to push the anti-corporate button all over again. True, two-thirds of Americans still think corporations make good products and compete well in the global economy, according to a *BusinessWeek*/Harris poll taken Jan. 16-21. Only a third, however, feel large companies have ethical business practices and just 26% believe they are straightforward and honest in their dealings with consumers and employees. “The backlash is beginning,” warned General Electric Co. Chief Executive Jeffrey R. Immelt at a talk with *BusinessWeek* Editor-in-Chief Stephen B. Shepard in New York on Jan. 15. “Credibility and trust is everything [in business]. And because of the recession, because of Enron, that trust has evaporated.”

Will the public mood become increasingly at



is with big business and the culture investing? Certainly, what's emerging is a political climate that appears much more open to government regulation than has been the case for years. A crackdown on the accounting industry seems likely. Board directors may get new rules about conflict of interest, as well as new responsibilities to oversee corporate audits. Companies also could face restrictions on the ability to fund 401(k)s with their own stock. "I worry that Enron will unleash a welter of restrictive new regulations," frets Steven A. Raymont, CEO of Tech Data Corp., a Clearwater (Fla.)-based computer distributor. Even campaign-finance reform could get a lift. After all, Enron's largesse has elected officials has created a widespread impression that it paid the cops its beat to take a nap. The Enron scandal clearly shows that legislators were influenced by campaign donations and didn't live up to their watchdog duties," says David Clay, a veteran treasury hand at Boeing's aircraft plant in Everett, Wash.

Of course, public anger and political furor often have a way of fading quickly in Washington. Gun control looked like a no-brainer after the Columbine shootings, but wound up blocked by powerful groups such as the National Rifle Assn. Corporate lobbyists are already working hard to head off Enron-related regulation. The heat also is unlikely to affect many of the broader deregulatory efforts that have brought sweeping

change to industries such as banking and telecommunications.

Clearly there are signs of a growing disenchantment with business. While the *BusinessWeek/Harris* poll shows that a core 16% of Americans have "a great deal of confidence" in people running major companies—up slightly from the 15% who felt that way in 1999—the percentage who have "hardly any" con-

more control over 401(k) plans. Limiting the amount of employer stock in such plans is only the first step. The AFL-CIO also argues that 401(k)s should be governed like union pension funds, with boards comprising employees as well as company officials. Such independent oversight could resonate widely. "There should be outside management of retirement funds," says Carol Otten, an

BusinessWeek/Harris Poll*

A GROWING SENSE OF ANGER

Disenchantment with Corporate America is on the rise.

► Would you say you have a great deal of confidence, only some confidence, or hardly any confidence in the people running major corporations?

	A GREAT DEAL	ONLY SOME	HARDLY ANY
1999	15%	69%	13%
2002	16%	56%	24%

► Enron executives have been charged with putting their own personal interests ahead of workers' and shareholders'. Do you think this is true of many other large companies, or not?

Is True	79%
Is Not True	14%
Not Sure	6%

* Based on a survey of 886 adults conducted Jan. 16-21, 2002. Results should be accurate within 3 percentage points.

► Enron employees had a lot of their 401(k) and retirement money in the company's stock, so they lost most of it when the company's stock crashed. Do you think the government should regulate companies more closely to prevent this from happening at other companies, or not?

Government should regulate	73%
Government should not regulate	23%
Not Sure	4%
Decline to Answer	1%

BusinessWeek online

For full poll results, go to the Feb. 4 issue online at www.businessweek.com

fidence in business leaders nearly doubled to 24%, from 13% in 1999.

Although there is no concrete evidence yet that Enron is adding to that disenchantment, many fear that the sordid tale will feed suspicions about self-dealing by executives and the nexus of influence between companies and politicians. The *BusinessWeek/Harris* poll finds that some 79% of Americans believe corporate executives put their own personal interests ahead of workers' and shareholders', as Enron officials are alleged to have done. Other polls find similar results. For example, a Gallup Organization poll released on Jan. 16 shows that 61% of those closely following the Enron story believe its executives did something illegal. Says Governor John G. Rowland (R-Conn.), head of the Republican Governors Assn.: "The average guy on the street sees the Enron mess and says, 'Oh, another corrupt corporation.'"

Reformers are moving to capitalize on such attitudes. Reacting to the pension losses suffered by Enron employees, for example, pension-rights and labor groups have ambitious goals to give workers

assistant vice-president in the Chicago branch of Commerzbank, a Frankfurt-based bank. "With the CEO not involved and no company stock in the fund, there wouldn't be this question of accountability" raised by the Enron case.

Other groups cite Enron as evidence of the need for new regulatory scrutiny of the big accounting firms. They argue that Andersen was lax because it got larger fees from consulting for Enron than from auditing the company's books. This is the rule in the industry, not an exception. In fact, the large accounting firms last year received just 28% of their aggregate fees from accounting, according to a study by the Investor Responsibility Research Center Inc., a nonprofit group in Washington that represents institutional investors.

To remedy the problem, some investors want to limit or ban auditors from consulting for the companies they audit, although the SEC appears little inclined to go along (page 38). Others want to require corporations to change their accountants every seven years. "Enron has given investors the weapon

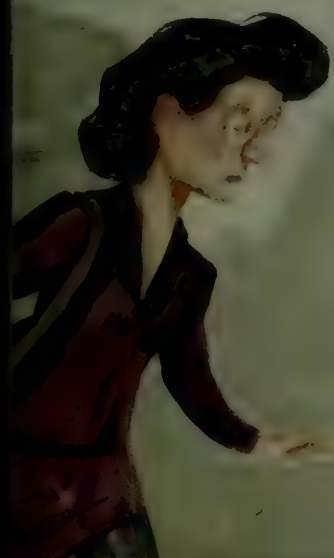


ILLUSTRATION BY TIM BOWER

they've been waiting for to really make something happen," says Carol Bowie, the IRRG's head of governance research.

In addition to reform groups, the pressure from skittish stock investors is having at least a short-term effect on some companies. For example, Kmart Corp.'s Jan. 22 bankruptcy filing was triggered in part by Enron-inspired fears (page 72). So was Tyco International Ltd.'s decision that day to split into four business units (page 70). Tyco CEO L. Dennis Kozlowski says he took the step to reassure the fast-growing conglomerate's investors that its complex financial reporting scheme involved no risky accounting—a move that wouldn't have been needed if the Enron meltdown hadn't renewed investor skepticism about its bookkeeping.

The biggest political question is whether the Enron backlash will suffice to push through campaign-finance legislation. Substantial curbs on campaign contributions could have a big impact on the way Washington is run. However, that's exactly why opponents are likely to stall any key votes until the scandal has died down.

The outcome of that battle could feed into the November elections as well. So far, there's no evidence that close ties to Enron executives led to any unethical actions by the Bush Administration on the company's behalf. But Democrats may try to use the opportunity to taint the President for his close association with Enron Chairman Kenneth L. Lay. More broadly, they may tap the anti-regulatory mood to paint the GOP as captive supporters of unregulated corporate power. "Obviously, that's the bigger political game here—to tie the Enron albatross around the necks of Republicans who believe that government should be less involved in markets," says Jerry Taylor, an environmental expert at the Cato Institute, a free-market think tank in Washington.

Of course, 10 months is an eternity in politics. Events may simply push Enron out of the public consciousness long before autumn. Still, many average Americans were suspicious of both corporations and politicians before Enron came along. The company's collapse, and the open question as to whether the government will take steps to guard against future corporate meltdowns, can only add to the public's growing sense of cynicism and mistrust.

By Aaron Bernstein in Washington, with Brian Grow in Atlanta, Darnell Little in Chicago, Stanley Holmes in Seattle, Diane Brady in New York and bureau reports

INVESTIGATIONS

THE SWAMP FOX ON ENRON'S TAIL

Is Billy Tauzin—a longtime accounting-industry pal—the right man to lead the Hill's charge?

Representative W.J. "Billy" Tauzin, the affable Republican chairman of the House Energy & Commerce Committee, once observed of his home state of Louisiana that "half of it is underwater. And the other half is under indictment." That pretty much sums up Tauzin: wickedly funny, disarmingly candid, and—given some of the politicians Louisiana has produced—painfully on the mark.

Sometimes called the Cagey Cajun or the Swamp Fox for his droll humor and deft politics, Tauzin is a master at using his committee to full effect. While he's leading just one of 10 groups looking into the Enron Corp. mess, count on him to be at the center of the action as the investigations heat up. Thanks to his early acquisition of documents and digging, much of what has come to light in recent weeks—including the letter that Enron executive Sherron S. Watkins wrote last August to CEO Kenneth L. Lay warning of the company's impending collapse—has come from

his team of 15 investigators.

The Enron probe won't be the first controversy to put Tauzin in the spotlight. Many of the highest profile congressional hearings of the past 18 months have been his doing. Remember the Ford-Firestone probe? That was his. The hearings into the election-night network-TV projections in Florida? Tauzin again. The California energy crisis? He was in the middle of that investigation, too. The explanation for his frequent forays? It's partly due to his committee's jurisdiction—and partly his own desire to be the showman.

But Enron clearly puts Tauzin in an uncomfortable position. As he doggedly pursues the hottest story in business, the southern Louisiana lawyer has had to do a little backtracking of his own. Until now, he has been one of the most abashed defenders of the accounting

industry in Congress. He took \$57,000 in campaign contributions from accounting firms. Arthur Andersen of the past 12 years, more than any other House member. What's more, he was instrumental in defeating former Securities & Exchange Commission Chairman Arthur Levitt Jr.'s efforts to clamp down on accounting industry conflicts of interest late 2000. "Today," says rather sheepishly, "it's kind of hard to see there isn't evidence of a problem.... Arthur Levitt was right."

It isn't the first time that Tauzin has d



PAPER TRAIL

Digging through Enron papers, Tauzin staffers found documents that may prove critical



TAUZIN'S SCORECARD

His earlier hearings generated headlines, but only modest action

FORD-FIRESTONE

Revised hearings examined tire blowouts and Ford Explorer rollover problems.

RESULT: A bit of money for oversight agency and modest new tire-safety legislation, but no sweeping reforms.

ELECTION-NIGHT COVERAGE

Heads inquiry into how cable and networks bungled vote tally.

RESULT: Nothing.

CALIFORNIA ENERGY CRISIS

He led probe of brownouts and price spikes in 2000.

RESULT: Tauzin championed the Bush energy bill through the House, but it's now bogged down in the Senate. Meanwhile California's problems have gone way on their own.

He has politically reversed his position. Colleagues—some admiringly, some not—call him Congress' "ultimate political chameleon." Indeed, the Cagey Cajun has changed his political stripes before, with no ill consequences. After the GOP

took control of the House in 1995, he not only switched parties but also negotiated his way into a powerful subcommittee chairmanship. In one quick move, he managed to stay in the majority and cut in front of several lifelong Republicans to head the panel that oversees telecommunications.

Tauzin's change of tune in the current controversy could have profound policy consequences. Once a staunch deregulator, he now vows a thorough look at how Big Business conducts itself. "We're finding out that there are real problems endemic in the structure of Corporate America that we need to deal with," he told *BusinessWeek*. "Enron is just the worst example."

But can someone who has reversed positions and been closely tied to the accounting business convince the public that he is earnest in his efforts to police it? Many believe that while Tauzin is brilliant at political theater, he's unlikely to go to the mat for tough new accounting rules. "Things like this make good television," says Bill Allison, managing editor of publications for the consumer watchdog group Center for Public Integrity. "But I don't know that they're going to make good law." Fur-

thermore, some critics observe that while Tauzin's talk is now tougher, he has no intention of giving back any of the industry donations he has received.

Even so, voters back home give the congressman a lot of maneuvering room. He's adored in his district along the Mississippi Delta for his panache and his help for local business. As a result, he has run unopposed in most of his recent reelection races, as a Democrat

or a Republican.

BACKTRACKING

Tauzin now says SEC efforts to crack down on accounting were "right"

Besides, as former Senator J. Bennett Johnston (D-La.) says: "Consistency is the hobgoblin of small minds. And Tauzin does not have a small mind."

Indeed, he's hoping to use those

smarts to prove doubters wrong. Already, committee staffers have interviewed former Enron CEO Jeffrey K. Skilling; David B. Duncan, the recently-fired Andersen partner who handled the Enron account; as well as that firm's risk-management chief, Michael C. Odom. Tauzin is also negotiating to meet with former Enron Chief Financial Officer Andrew S. Fastow, who managed and had stakes in some of the risky partnerships that caused the company to crater.

But there is the potential for disappointment, too. He has set the stage for his own high-profile hearings by selectively releasing some of the tens of thousands of pages of Enron and Andersen documents his staffers have culled through, and his new challenge will be to deliver something more than headlines. Moreover, Tauzin must also take care not to do anything that would undercut the criminal probes undertaken by the Justice Dept.

For now, though, Tauzin is playing it cool. While his staff was hunting through records over the Martin Luther King Jr. holiday weekend, he was chasing deer in Alabama and keeping in touch with his crew via BlackBerry. "He may be hunting deer," one staffer laughed, "but he's got his dogs hunting Enron." After the upcoming hearings, Tauzin may have some more headlines for his scrapbook.

By Dan Carney and Laura Cohn in Washington, D.C.

BusinessWeek online

For more coverage of the Enron investigations, go to the Feb. 4 issue online at www.businessweek.com

COMMENTARY

By Mike McNamee

PITT'S ACCOUNTING FIX LEAVES A LOT BROKE

A powerful regulator vows to crack down on an influential industry. The industry smiles and calls the proposal "constructive" and "welcome"—even in private. What's wrong with this picture? Simple: Securities & Exchange Commission Chairman Harvey L. Pitt's proposal to put "real teeth" into auditor discipline has some big gaps where the gums are showing.

Pitt's proposal—unveiled on Jan. 17 as a work in progress—does take ethics, discipline, and quality control in auditing away from the American Institute of Certified Public Accountants, an industry group that has run accounting's discipline system for the past century. Instead, Pitt proposes to give those powers to a disciplinary board of as-yet-undetermined size. A majority of the members will not be accountants, and it will have a professional staff of investigators. The Big Five and other accountants that audit public companies would be required to comply with the board's requests for evidence and would be subject to its discipline. The result, says Pitt: "a tough, no-nonsense, fully transparent discipline system."

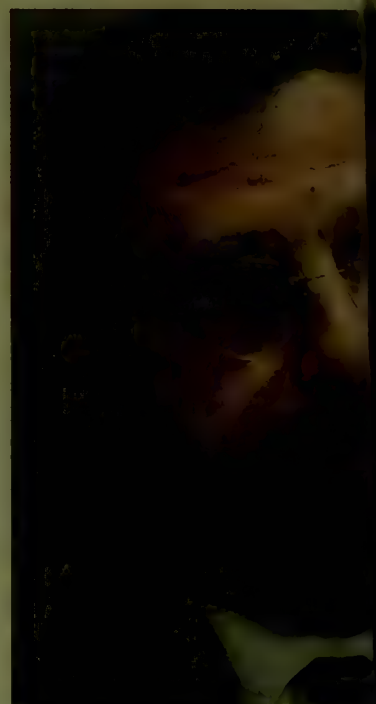
Would that it were. In fact, the new board will lack the critical powers it needs to ensure its independence and effectiveness. In the wake of the Enron collapse, Congress and investors are demanding vigorous oversight for auditors. By failing to stake out a tough opening position, Pitt is undermining his own credibility on Capitol Hill—especially since he counts the AICPA and the Big Five among his past clients. And he's worsening chances of real reform.

What does the new board need? For starters, delegates from the AICPA should be banned. That's the view of Charles S. Bowsher, formerly Uncle Sam's chief auditor and now chairman of the Public Oversight Board, a group of five prominent retired businesspeople currently charged with reviewing the

Big Five's audits. The POB voted on Jan. 20 to disband itself in protest of Pitt's decision to replace it with a board that includes CPAs, arguing in part that the move will weaken rather than strengthen independent oversight. The CPAs on the board "will have so many resources, so much legal talent, that the profession will soon be running the system," charges Bowsher. That's damning criticism from a body that has itself been widely criticized for being ineffective at combatting accounting transgressions.

The new board will also need subpoena powers since evidence of failed audits must come from companies as well as accountants. And it must scrap AICPA's practice of deferring discipline until all lawsuits are settled. Other self-regulators, such as the New York Stock Exchange, don't give members that shield.

To win such powers, the disciplinary board should have a clear public mandate—and that requires the backing of Congress. "Three years from now, when nobody is paying attention, a private board can just let things slide," says



quire clients to cough up documents. Deferring discipline is fine, the cause accused accountants will be pending while their cases are pending. "We are encouraging the accounting profession to take full responsibility for helping to solve this problem,"

But Pitt's insistence on working the terms with the Big Five firm meeting with the POB or critics of the progress and elsewhere, is the heart of the problem. Those who know him

even past foes—do Pitt is purposely going on ex-clients. Instead seems hampered by left over from his 20 as a private security lawyer. He's practicing the art of the deal—negotiating toward a settlement takes away the cherished control of discipline but that doesn't CPAs more than need. And he believes so in his own integrity that he can't see how serious would question his himself approach.

Now, though, Pitt's different role—and to grow into it. A

line toward the Big Five may be the only way for the SEC to emerge with credibility intact—and with the discipline system investors desire.

McNamee covers Enron from Washington

THE SEC CHAIRMAN'S PROPOSAL

WHAT IT HAS...

INDEPENDENT FUNDING A disciplinary board would be funded by accountants, stock exchanges, and others

STRONGER DISCIPLINE The SEC would review each case and step up enforcement efforts against financial fraud

IMMEDIATE SUSPENSION Pitt would suspend accountants from practice while charges are pending

...AND WHAT IT LACKS

SUBPOENA POWER Pitt's board couldn't compel documents or testimony from auditors and companies

AUDITOR OBJECTIVITY While critics want Pitt to block the Big Five from consulting for audit clients, he isn't likely to go that far

INDEPENDENCE SAFEGUARDS Because of their expertise, CPAs on the board could soon dominate it

John C. Coffee, a Columbia University law professor.

But the SEC's top dog seems to think he can work out a new system without legislation. Nor will the new board need subpoena powers, his aides say, because the Big Five's audit contracts can re-

**"We are encouraging
the accounting
profession to take full
responsibility for
helping to solve this...."**

HARVEY PITT
Chairman, SEC

on a host of issues. Another constraint is equally daunting: Legal ethics forbid him from acting on information he obtained from ex-clients. "It's impossible to see Harvey Pitt as anything but Prometheus bound. Pitt is shackled to a rock, and the harpies are going to come and pick his guts out," says Bill Singer, a New York securities lawyer.

The heart of his future difficulties can be found in a single-spaced, six-page document that Pitt filed with the U.S. Office of Government Ethics on May 24, 2001, after he was nominated to the SEC. It lists Pitt's 112 clients during the preceding two years. Apart from the Big Five accounting firms, the list includes major banks, the mutual-fund and securities industry trade groups, brokerages such as Bear Stearns and Morgan Stanley Dean Witter, the New York Stock Exchange, hedge fund titan Dawson Samberg, and corporations such as media giant America Online and its Chairman Stephen M. Case.

Virtually all could be affected by SEC work in the coming years. The NYSE is vitally interested in issues affecting its heated competition with Nasdaq and electronic trading networks. Charles Schwab and Datek Online closely follow issues affecting online trading, and Nasdaq market making giant Knight/Trimark Group has pressed the SEC not to curtail payments for order-routing, and weighed in on other trading issues.

Pitt has dealt with potential conflicts by hewing strictly to the law. His spokesperson, Christi Harlan, notes that "people can always believe that there is the appearance of a conflict of interest, but in [Pitt's] agreement with the Office of Government Ethics he has agreed not to be involved in any matter involving former clients for a year [ending in August], which is what the law requires."

But potential conflicts won't go away just because Pitt is following the rules. If he takes action concerning former clients—even clients from years ago, not on the list—after August, lawyers say he may be seen as either favoring them or bending over backwards to do otherwise.

Either way, you "lose the moral high ground," says one securities lawyer. "You want to avoid the appearance of a conflict as well as a real conflict," says Ira L. Sorkin, a former SEC regional administrator and now a New York securities lawyer. Sorkin notes that while he has confidence in Pitt's fairness, "you don't want to create any issues that will call into question a particular deci-

sion. It's something that judges and senior people in government avoid."

Pitt has already lost the moral high ground in the No. 1 issue on the SEC's agenda. His credibility is open to serious question on many other subjects vital to the markets. And if Pitt's baggage reduces public confidence in the SEC, it may be time to consider if the price of his expertise is too high.

Senior writer Weiss covers Wall Street.

POSSIBLE MINEFIELDS

*SEC Chairman Harvey Pitt's
many former law clients
could pose ethical dilemmas
during future proceedings.*

Among them:

CORPORATIONS

America Online
Dell Computer
El Paso Natural Gas
General Instrument
Humana
Louisiana-Pacific

SECURITIES & INVESTMENT

Bear Stearns
Charles Schwab
Datek Online
Dawson-Samberg
Gruntal
Investment Company Institute
Knight/Trimark
Merrill Lynch
Montgomery Asset Management
Morgan Stanley Dean Witter
New York Stock Exchange
PaineWebber
Securities Industry Assn.
TIAA-CREF
Tiger Management

BANKS & INSURANCE

Bank of America
Bank One
Cigna
Lincoln National Life
Lloyds of London
Securities Investment Protection
Reliance Group

DATA: U.S. OFFICE OF GOVERNMENT ETHICS

For the full list of Pitt's former clients go to the Feb. 4 issue online at www.businessweek.com.

COMMENTARY

By Gary Weiss

REGULATOR WITH HIS OWN CONFLICTS OF INTEREST

Two decades of dedicated service to an array of corporations, Securities & Exchange Commission Chairman Harvey L. Pitt won renown as a scholar. But that expertise came at a price—a close identification with the interests of his clients. Controversies over Pitt's history of legal representation for the Big Five accounting firms, including Enron auditor Arthur Andersen, threaten to undermine his reputation in formulating accounting rules and Pitt's conflict-of-interest agreement may only be just beginning. A partner in the Washington law firm of Frank Harris Shriver & Associates, he represented firms and individuals throughout the financial-services industry. Although most previous SEC regional securities lawyers, Pitt's practice was unique in its sheer size and scope. Lawyers say that Pitt thus has no real or apparent conflicts of interest that can be just as troubling—

THE PARTNERSHIPS

THE MAN BEHIND THE DEAL MACHINE

As creator of iffy Enron partnerships, ousted CFO Andrew Fastow is a prime target for investigators

When it comes to Andrew S. Fastow, the former Enron Chief Financial Officer, there's one thing those who worked with him agree on: He never appeared anything but supremely self-confident. Early in his career at Enron, when Fastow was just another bright young executive at the energy company, he bargained relentlessly to win a concession from a banker. Afterward, Fastow thanked him and said: "I'll remember that when I'm CFO."

Now, some see Fastow's cockiness as one factor behind Enron's collapse into the biggest bankruptcy in U.S. history. Certainly he wasn't the only top executive at Enron with that kind of attitude; the word most people use to describe the company culture is arrogant. But Fastow was one of the few whose aggressive tactics and overconfidence had the capacity to turn dangerous for the company.

If former CEO Jeffrey K. Skilling was the architect behind Enron's transformation from stodgy pipeline to high-tech trading powerhouse, Fastow was the trusted lieutenant who created the increasingly complex and unusual off-balance-sheet financing that fueled Enron's growth. He was also key in selling the deals to banks and institutional investors—sometimes with veiled threats and sometimes with sweet talk, say those familiar with his tactics. "He had a dual personality. He could be charming but he could also be irrationally mean," says one high-ranking insider.

As congressional investigators, the Securities & Exchange Commission, the Justice Dept., and shareholders' lawyers try to pin down the culprits in Enron's demise, Fastow, 40, has fast become one of the primary targets. He devised the LJM partnerships that triggered the controversy over Enron's accounting. His

lawyers stress that the LJM partnerships, which Fastow ran and had stakes in, were approved by top management and the board. They also note that Fastow had no oversight of the accounting for these deals—that was the responsibility of another Enron executive who did not report to him. Fastow spokesman Gordon G. Andrew says that "Enron senior management had full knowledge of the LJM transactions." But some former and current Enron executives believe that Fastow may have hidden some aspects of the partnerships—including the involvement of other insiders—from Chairman Kenneth L. Lay and Skilling.

To many colleagues and bankers who knew him, it is easy to draw Fastow as one of the villains in this story. Insiders saw him as sometimes volatile and vindictive, determined to get to the top by pleasing Skilling. That meant putting together creative financial structures that ensured Enron could expand its business without adding too much new debt to the balance sheet or threatening its crucial credit rating. But Fastow's desire to follow Skilling's lead didn't end there. To build his new home in the exclusive River Oaks section of Houston—where construction continues despite Fastow's troubles—he hired the same architect Skilling had used, says a source familiar with the project. Some at Enron even

ANDREW FASTOW

BORN Dec. 22, 1961, Washington

EDUCATION BA in economics and Chinese from Tufts University, 1984; MBA, Northwestern University, 1987

POSITION Former chief financial officer, Enron. Removed from post in October, 2001, amid controversy over off-balance-sheet partnerships that he ran and held stakes in.

CAREER TRACK Worked in structured finance group at Continental Illinois Bank from 1984 to 1990. Joined Finance in 1990 and developed relationship with up-and-coming ex-Jeffrey Skilling. Fastow became CFO in 1998 with Skilling's backing.

WHAT EVERYBODY WANTS TO KNOW Did Fastow hide some aspects of



ne to believe that Fastow named his son, Jeffrey, after Skilling—a contention denied by Fastow's wife through friend. "I don't think Andy ever did anything that Jeff didn't tell him to do," says one former co-worker. Adds another high-level insider: "He wanted to see Jeff happy."

Former colleagues say Fastow's booming, table-pounding style suited aggressive Skilling. And Fastow's

mined to change all that; even then he was pushing Enron to take advantage of the newly deregulated energy business. Fastow clearly sensed opportunity. And his wife Lea hailed from the wealthy Weingarten realty and grocery family in Houston, so he was eager to move to Enron's hometown. Lea, an MBA who had also worked at Continental Illinois Bank in Chicago, joined Enron, too, in the treasury department. She left the

company in early 1997.

Fastow and Skilling quickly became partners in the effort to reshape Enron, and Skilling looked to Fastow to help develop the financing that would fuel the growth of his empire.

estimates that Fastow controlled some \$80 million to \$100 million in annual fees for a wide variety of banking and investment banking services. Reluctance to join an Enron deal or persistent questioning about the terms would lead to threats that they'd be cut out of future business, some bankers say. To help in its arm-twisting, Enron kept an internal spreadsheet listing which banks were in which deals and what they made. Fastow and his team would also sell their deals by hinting that even these off-balance-sheet structures were somehow backed up by Enron, says one former banker who did business with the company. And Fastow could also turn on the charm: He delivered flowers to the house of one banker after his son's baptism. Fastow's spokesman denies that he ever threatened bankers to get them into Enron's deals.

Fastow's hard-nosed business style doesn't square with the Andy that friends and acquaintances saw outside



DOWNGRADE? Early partnerships were backed by oil and gas

payments, but soon Enron began using a hodgepodge of assets, some of dubious quality

CONSTRUCTION HAS RESUMED ON FASTOW'S NEW HOME IN TONY RIVER OAKS

At first, the off-balance-sheet financings created by Fastow and his group were not particularly risky, say bankers familiar with the deals. Early ones were backed by payments from oil and gas producers. But before too long, they say, Enron began using its growing clout to include in the deals a hodgepodge of assets, some of dubious quality, and a range of unusual provisions. One banker recalls a partnership that had very few restrictions on what energy assets Enron could put in; his bank eventually started turning some of the deals down. Another banker was stunned by an on-balance-sheet financing that was to be backed up by third-party receivables. The problem was that Enron also included the right to replace the receivables with its own paper, which is now almost worthless. That deal was code-named Tammy, after Tammy Faye Bakker, and included her picture on the tombstone presented to participating bankers. As the banker recalls: "I said, 'Is it that ugly?'"

So why did so many bankers go along? Most didn't want to miss the Enron gravy train. One Houston banker

of the office. He was a major benefactor to the city's art museums, a fundraiser for the local Holocaust Museum, and a co-founder of a synagogue. "The Andy Fastow I know is one of the most thoughtful and generous people in Houston," says Robert E. Lapin, an attorney who is one of Fastow's closest friends. When one of Lapin's three children was diagnosed with a rare disease, Fastow was one of the first to call. "He said, 'You just tell me when and how you need help and I'll do it,'" says Lapin. Even old chums from New Providence (N.J.) High School recall Fastow as popular and well-liked, though extremely ambitious. He was the first permanent student representative to the New Jersey State Board of Education, for instance, a post he pushed to create.

Now as friends and colleagues try to figure out how Fastow landed in the middle of one of the biggest financial scandals ever, that driving ambition is looking more and more like a liability.

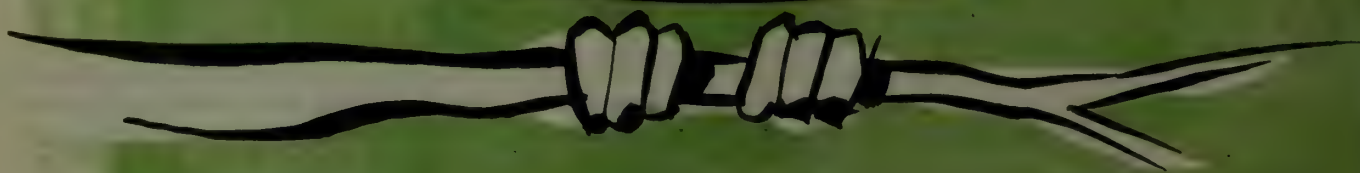
By Wendy Zellner in Dallas, with Mike France in Houston and Joseph Weber in Chicago

pendant for belittling co-workers certainly didn't hinder his climb to the top. "He loved to make people look stupid," says one Enron executive. "He seemed to do it most when he was in front of a lot of people." Some former co-workers say he often remembered personal slights or grudges when it came time for performance reviews; at Enron, the top managers could offer their evaluations of anyone, even those who didn't report to them.

The aggressiveness was all in service to Skilling's plan to transform Enron into a fast-growth, technology-oriented trading company: the company of the future. When Fastow joined Enron's finance group in 1990, the company, and the energy industry in general, were still considered backwaters for bright young MBAs. Skilling was deter-

ships from Enron's top execs and which approved the deals?

Married grocery store and real estate agent Lea Weingarten, who previously worked at Continental Illinois and they have two sons. When naming partnerships that later triggered scandal, he used the first letters of his and two sons' names.



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COMMENTARY

By Mara Der Hovanesian

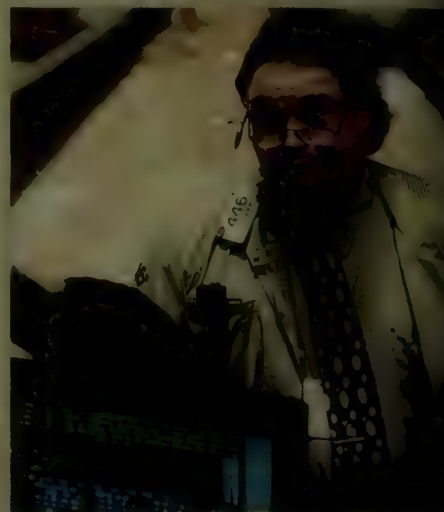
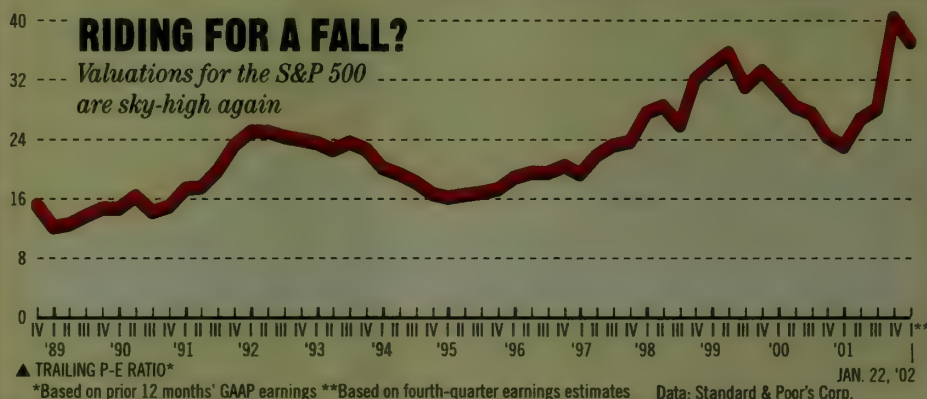
BRUTAL HONESTY COULD FORCE A MARKET CORRECTION

The heat is on for Corporate America. In the wake of the Enron Corp. debacle, the quality of earnings is being questioned as never before. Fancy accounting footwork has raised the ire of Congress. Credit-rating agencies are promising to intensify their scrutiny of fuzzy numbers. And it's not just the bad stuff hidden off balance sheet that's raising eyebrows. Now, even the earn-

are still using so-called pro forma accounts, which allow companies to present their earnings in the best possible light. By that reckoning, the companies in the Standard & Poor's 500-stock index earned \$45.31 last year, giving the market a price-earnings ratio of 24.7, according to Thomson Financial/First Call. But by using generally accepted accounting principles, the most conservative measure,

to \$24 for 2001 and \$37 for 2002.

To be sure, the big picture is heartening for the market. Manufacturing has picked up steam, and the Federal Reserve Board's 11 rate cuts have built up tremendous liquidity—two scene-setters associated with rising p-e ratios. Productivity is stronger than in previous recessions, and benign inflation of 1.5% has also justified higher multiples historically.



ings of such blue chips as IBM and General Electric Co. are getting closer examination.

The impact is already discernable. "Any company that has earnings that people are suspicious of has been taken down in the market," says John D. Chadwick, money manager at New York's Bessemer Trust Co., a private bank. Case in point: Tyco International Ltd., whose accounting has been questioned by analysts and short-sellers. When it announced on Jan. 22 that it would divide its manufacturing businesses into four companies, investors yawned even as its execs claimed it might be undervalued by as much as 50%. "Tyco did nothing to allay concerns about their accounting," says Chadwick.

The trend may lead to much tougher accounting practices. That's ultimately good news for the stock market. But in the short run, it raises big questions about whether stocks are now badly overvalued. Many on Wall Street

earnings were just \$28.31 in the 12 months through September. That equates to a p-e ratio just under 40.

Such a huge valuation discrepancy doesn't look sustainable over the long haul. Moreover, by historic standards, the GAAP-based valuations are very high; even in early 1999, the p-e topped out at roughly 36. Those factors could lead to another sharp market correction, especially if pension funds and money managers opt for a much more conservative view of earnings in the future.

For now, Wall Street is behaving as though nothing much has changed. The S&P is up 17% since its September lows, and only a few of the rosy earnings estimates for 2002 have changed. Consensus estimates call for a 16.9% rise over last year. Prompted by the changes to accounting rules, however, Goldman, Sachs & Co. top strategist Abby Joseph Cohen cut her operating earnings forecast for the S&P 500 by about one-third,

"It's not as bad as it seems," says Joseph S. Kalinowski, equity strategist at Thomson Financial Market Strategy. And analysts are tending to err on the side of caution. While only a third of the S&P companies have reported fourth-quarter earnings, those that have are beating consensus estimates by 3.3%, up less than 1% last quarter.

But earnings jitters may yet rock the markets. More shaky accounting practices could come to light. Some companies won't have registered the full impact of the downturn on their books, while others will still massage their numbers. Investors have "every reason to be twitchy," says Guy R. Elliffe, senior vice-president of Jurika & Voyles Inc. in Oakland, Calif.

If companies want to avoid onerous restrictions from Congress and others on how they report earnings, they need to clean up their accounting act. Those with the most transparency will be rewarded with higher stocks. And they'll deserve it.

Der Hovanesian covers Wall Street.

Fast-and-loose accounting standards may have led to an overvalued market

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EDITED BY MONICA ROMAN

A FAST BREAK FROM McDONALD'S

McDONALD'S HAS LONG SUFFERED from high turnover among entry-level employees. Now, the revolving door has reached the top of the fast-food operator. Barely six months after taking responsibility for all McDonald's outlets in the Americas, Alan Feldman, 49, resigned on Jan. 21. His move came only six weeks after Jeffrey Kindler, who headed the company's non-McDonald's outlets, resigned to join Pfizer.

McDonald's earnings have declined for four quarters in a row, in large part because of sluggish sales in the U.S. amid consumer grumbling about poor service and food. Feldman has no immediate job plans. His duties were assigned to James Skinner, 57, who was promoted to president and chief operating officer of McDonald's 29,000-unit restaurant group. A 31-year McDonald's veteran, Skinner

had been in charge of all Mickey D's outside the Western hemisphere.

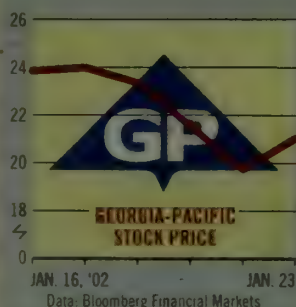
MAKING PEACE AT CREDIT SUISSE

JOHN MACK WAS HIRED IN July as CEO of Credit Suisse First Boston to end a major embarrassment: probes by the Securities & Exchange Commission, the National Association of Securities Dealers, and the Justice Dept. into how CSFB's technology group underwrote and distributed shares in initial public offerings. On Jan. 22, Mack succeeded. Without admitting or denying regulators' allegations, CSFB agreed to pay \$100 million to settle charges that it siphoned "tens of millions of dollars of customers' profits" in exchange for IPO shares. It also agreed to discipline the employees involved in the matter, although it did not specify the number or their names.

CLOSING BELL

TIMBER!

Georgia-Pacific's shares plunged 15% on Jan. 22, to 19.75, when a deal to sell its building products unit to Willamette Industries died. Instead, Willamette sold itself to rival Weyerhaeuser for \$6.1 billion. Georgia-Pacific bondholders have reason to worry, too: Its debt will soon likely be downgraded to junk.



COMPAQ IS IN THE BLACK

AFTER A DISMAL THIRD QUARTER, Compaq Computer's outlook for the fourth period was conservative. But no one knew quite how low it had set the bar, until Jan. 16. The Houston computer maker had projected a loss but turned in a \$92 million profit for the fourth quarter. Executives attributed the surprising performance to stronger-than-expected demand for home PCs, a 31% surge in European revenues, and continued cost-cutting. While Compaq still expects its usual first-quarter sales decline, the company says corporate demand for tech gear could rebound by midyear. More important, the strong results could mute critics of its troubled merger with Hewlett-Packard, says CEO Michael Capellas. "The tide is turning," he says.

HEADLINER: CRAIG VENTER

DECOUPLING A GENE DECODER

THE MAN WHO LED THE way to reading humanity's genetic code, J. Craig Venter, stepped down on Jan. 22 as president of Celera Genomics, which he helped found in 1998 to undertake the historic gene decoding. As Celera began to shift its focus from selling genetic information to discovering its own drugs, "we realized how much we didn't know about this drug business," explains Tony White, CEO of Ap- plera, Celera's parent.

So White decided that Rockville (Md.)-based Celera needed an experienced drug-industry hand at the

helm, which left little room for the irrepressible Venter. In addition, the two forceful men often

didn't see eye to eye.

"Craig always has his mind on the lofty science, which doesn't mesh very well with business," says fellow gene sequencer Richard Gibbs of the Baylor College of Medicine. "And he doesn't like to be told what to do."

Venter, who was on vacation and declined comment, will become chair of Celera's scientific advisory board. But the search for his replacement is only beginning.

John Carr



WELDON GETS THE NOD AT J&J

THEY'RE CHANGING THE GUARD at Johnson & Johnson. On Jan. 22, the health-care giant announced 53-year-old William Weldon would take over as chairman and chief executive officer in April, succeeding Ralph Larsen. Weldon began as a sales representative at J&J in 1971 and most recently has been running its \$15 billion pharmaceutical operation. He will take over as J&J is posting healthy gains on big products, including its blockbuster anemia drug Procrit. Still, analysts caution Weldon must rev up J&J's research and development operation.

WOZNIAC AND A FLEDGLING WOZ

STEPHEN WOZNIAC, CO-FOUNDER of Apple Computer, is back in the startup game. After

more than a decade on sidelines, Wozniak has veiled a new venture, dubbed "Wheels of Zeus" based on his own nickname, "Woz." The Silicon Valley fledgling, which will focus on developing wireless technologies for the consumer market, raised \$2 million from venture capitalists. Wozniak says he has put up any of his own cash so that he will be a more disciplined manager. "When my own money goes into something, I start to become careless," says Wozniak, who will serve as CEO of the startup.

ET CETERA...

- Northwest and America West airlines ended "blackout" periods for frequent-flier awards.
- EMI paid Mariah Carey \$28 million fee to end its four-album deal with the singer.
- Yahoo! is expanding its searches, a market dominated by Lexis Nexis.



You see a voicemail waiting on your laptop. So now you can share and respond to information however you want. It's possible when Avaya transforms your company's voice and data systems by getting them working together. Reliably. Securely. With our innovations in voice and in-depth expertise in data, you stay accessible, you stay connected. Find out why more than 90% of the FORTUNE 500® use Avaya communications to power their business, visit avaya.com/nowone.

AVAYA

COMMUNICATION WITHOUT BOUNDARIES

Regulators in China, Hong Kong and the U.S. are painfully aware that scandal is rattling Bank of China, one of the mainland's four biggest banks. One case goes right to the top. Former Chief Executive Officer Wang Xuebing is now detained for alleged misconduct in the matter of a \$23 million loan. The fraud, which involves the bank's New York office, has just forced the bank to pay Chinese and U.S. authorities a \$20 million fine.

But scandal is not just stalking the executive suite at Bank of China. Details are now coming out of a theft at the bank that makes the Wang case look like a financial footnote. Almost half a billion dollars are missing from the bank's accounts, and police in China, Hong Kong, and Canada are trying

to find the money and the bank executives who allegedly masterminded the scam. While they look, the integrity of China's banks is

**THE KAIPING
SUB-BRANCH:**

*Hatched here,
the scam last-
ed nine years*

bound to get a serious knock just as the country enters the World Trade Organization. The thefts are raising troublesome questions about China's ability to regulate its financial system, even as that system is being thrown open to the forces of the free markets.

The tale starts at Kaiping Sub-Branch of Bank of China. While Kaiping is a prosperous manufacturing town in Guangdong province, the branch itself seems an unlikely place from which to engineer a major international financial scam. Set in one of the town's only skyscrapers, the branch's empty lobby and trickle of customers make it look more like a monument to its managers' egos than a commercial enterprise.

But the Kaiping Sub-Branch is now the focus of a probe involving dozens of investigators on two continents. For it was through Kaiping that a group of Chinese bank executives allegedly diverted millions from Bank of China over a nine-year period starting in 1992 and ending last October. Senior Bank of Chi-



CHINA

THE BLACK HOLE

How \$480 million disappeared from Bank of China

The theft is raising troublesome questions about China's ability to regulate its financial system

na executives believe that when the damage is totaled up, the loss will total some \$480 million. Only about \$75 million has been accounted for so far, and much of that appears to have been lost in the crash of the Hong Kong real estate and stock markets after 1997. A Hong Kong police source says of the probe: "It's a big one."

Hong Kong investigators believe that the theft involved Bank of China branch staff in Kaiping and Guangzhou, capital of Guangdong, along with accomplices in Hong Kong and Vancouver, where some of the money now resides. Four people have been arrested in Hong Kong and charged with "dealing in property known or believed to represent the proceeds of an indictable offense." Their arrests were made in October, but details of the cases have just come out in documents filed in a Canadian court. Meanwhile, Canadian police may be looking for three other suspects who Hong Kong authorities believe fled to Vancouver, including the purported mastermind of the scheme, a former Kaiping branch manager named Fan Xuchao.

The Kaiping case casts a harsh light on Beijing and Hong Kong regulators, who allowed the leakage of Bank of China funds to go on for almost a decade without detection. David T.R. Carse, deputy chief of the Hong Kong Monetary Authority, defends his agency, saying money laundering is a "global problem" and that Hong Kong has stepped up its surveillance of the banking system in recent months.

In setting up their operation, the Kaiping gang allegedly used a scam common among Chinese companies the go-go 1990s, when China-linked banks boomed on the Hong Kong bourse. Many mainland Chinese set up so-called "window" companies to speculate in stocks and real estate in Hong Kong—China's window on the rest of the world. In local parlance, window companies that indulged in such speculation were "stir-frying" investments. According to investigators, Fan and his confederates cooked a storm.

Some of the window companies were legal, while many occupied a gray area.

All had to contend with strict Chinese laws against moving money from the mainland. Often, funds were diverted from mainland companies and banks by employees who wanted to play the markets. Those who "borrowed" this way would pay their employers back if they made money. If not, the scamsters relied on creative accounting to cover their tracks.

In the Bank of China case, Hong Kong authorities allege that Fan started skimming money in the early 1990s, when he worked at the Kaiping branch. In 1999, he was promoted to a managerial job at the Guangzhou regional headquarters. From 1999 until he fled last October, Hong Kong authorities assert, he conspired with two managers at the Kaiping branch, Xu Guojun and Yu Zhendong, to steal almost \$75 million. What happened to the \$405 million that disappeared before Fan's promotion isn't yet clear.

Fan's principal Hong Kong window company, authorities say, was Ever Joint Properties, founded in 1993. Fan is said to have recruited a relative, Hui Yat-sing, to set up Ever Joint. Hui was arrested in Hong Kong in October, along with his wife and two others. Contacted through a spokesperson, Hui refused to comment. The lawyers of the other arrested suspects couldn't be reached.

Much of the money deposited at Ever Joint moved on to other accounts at elite financial institutions. According to court documents filed in Vancouver, Fan and his partners had deposit and brokerage accounts at Hong Kong branches of ING Bank, Standard Chartered Bank, Fortis Bank, UBS, and HSBC Broking Securities. Contacted by *BusinessWeek*, Standard Chartered said it is cooperating with police on the case. The other banks refused to comment.

Fan and company invested millions of dollars in Hong Kong stocks—apparently with disastrous results. Ever Joint's

biggest stock position was in Leading Spirit High-Tech Holdings Ltd., a China stock that has plunged 99% from its 1997 high. The group also bought a stake in tycoon Richard T.K. Li's Pacific Century CyberWorks Ltd. Worth \$4 million when the stock peaked two years ago, the stake is now valued at \$321,000.

The Bank of China's loss was not discovered until the three main suspects, Fan and his bank cohorts, Xu Guojun

and Yu Zhendong, fled China, apparently last October. Though Hong Kong police believe they're in Canada, the Royal Canadian Mounted Police say they have not yet made an arrest. An RCMP spokesman says, however, that the agency is examining a "roomful of documents that may have evidence of alleged wrongdoing" by the trio. Canadian bank accounts containing a total of \$3.8 million have been frozen. Accounts in Hong Kong containing an unknown amount of money have also been frozen.

The Kaiping case has given added impetus to attempts by Bank of China Chair-

man Liu Mingkang to install more sophisticated risk management measures. But the explosion of bank corruption won't be ended easily. Part of the problem is that Chinese bankers receive pitifully small salaries by international standards. The top execs at China's four major banks typically make just \$3,600 to \$4,350 a year. Fan, of course, made much less. "You have government officials controlling substantial amounts of resources, and you pay them almost nothing," says an adviser to several mainland enterprises. "It provides an incentive for people to steal." Unfortunately, that incentive is working all too well.

By Mark L. Clifford in Hong Kong and Petti Fong in Vancouver, with Miguella Lam in Hong Kong, Alysha Webb in Shanghai, and Dexter Roberts in Beijing

'STIR-FRYING' THE MONEY

THE SCAM

As much as \$480 million was diverted from Bank of China's Kaiping Sub-Branch, then invested in local stocks and real estate or moved abroad.

WHO DID IT

Former Guangdong branch officials and their accomplices are suspected. The thefts went on for nine years.

WHERE'S THE MONEY?

Canadian authorities have frozen accounts containing \$3.8 million. The rest may have been spent or lost in the markets.



WIRELESS BY SAMSUNG: Korean companies have big ambitions to export their cutting-edge technology to the West.

SOUTH KOREA

A NATION OF DIGITAL GUINEA PIGS

Korea is a hotbed of such experiments as a cash-free city

At first glance, Seongnam seems like any middle-class Seoul suburb: a mix of high-rise apartment blocks, restaurants, and malls. But Seongnam's humdrum exterior masks serious technological ambitions. Over the next three years, municipal officials plan to transform the town of 930,000 into the world's first digital city. That means using multiple broadband connections to do away with some really worn-out analog concepts—like cash and credit cards. When you think of it, says Deputy City Director Jung Chang Sop, cash is just a “hassle.” So in March Seongnam will start equipping citizens with digital cell phones that, in effect, pay for purchases at every store in the city.

Cash-free Seongnam is just one of many on-the-ground tests being launched in South Korea, a nation with a collective mania for things digital. More than half of Korea's 15 million households have broadband service, while more than 60% of Koreans carry cell phones. Korea's telcos are already trying out third-generation mobile handsets, designed to handle high-speed wireless transmission of video, data, and voice. In the securities markets, about 70% of all share trades are done online.

The country is now so wired that Korean companies can use entire urban populations as guinea pigs for their latest digital contraptions. That's important for local firms that want to export their knowhow abroad. But Laboratory

Korea is key for foreigners too. “We have a guy posted there all the time on the lookout for deals,” says Brian Baglow, an executive at online games company Digital Bridges Ltd. in Scotland. “We're very, very focused on Korea because it has such an advanced user base.”

These advanced users are up to a lot. Take the Seongnam phone foray. Some Scandinavian communities use cell phones as payment tools, but the Seongnam experiment, launched by Harex InfoTech, the credit card unit of Kookmin Bank, the nation's largest, and LG Telecom, is one of the first to rely on infrared technology. Consumers will pay for purchases by entering a personal identification number on their phone, then shooting an infrared ray from their handsets to a tiny infrared board located by a store's cashier. The ray will transmit credit-card information to the store, and the user will be billed. Similar transactions can happen at bus stops, vending machines—wherever that infrared patch can be posted to relay the digital billing data. “We may even let handset holders exchange name cards by pointing their phones at each other,”

says Harex director Kang Bong He.

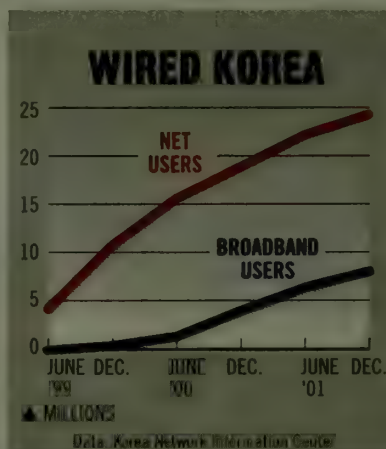
Seongnam isn't the only city with initial dreams. KT, Korea's largest phone company, has set up antennas at crowded spots around the country to provide wireless broadband connections to anyone whose notebook or personal digital assistants is equipped with a local area network card. Users move into an area where a LAN is functioning—a subway station, a restaurant, an airport—and they have an instant, always-on connection. The system is easy to install, does not chew up a lot of spectrum, and is much cheaper than a traditional cell-phone network. By the end of the year, such antennas will be available at 10,000 places around the country. “KT is emerging as a pacesetter,” says John Yang, CEO of Lucent Technologies Korea.

Meanwhile, with a full-scale introduction of 3G likely in Korea by April,

Samsung is launching a line of multifunctional gadgets to navigate the high-speed wireless Web. “Super infrastructure enables us to roll out leading-edge products,” says Phillip Chung, a Samsung vice-president. This month, for example, the company began selling the Nexio, one of the most powerful Net-enabled handhelds going.

It combines Microsoft's Office and wireless Web-browsing functions with an MP3 player, telephony, voice-recording, and digital-camera capabilities. By summer, Samsung will introduce Nexio in the U.S. with an \$800 price tag. Digital at home, digital abroad: Korea's online experiment roars ahead.

By Moon Ihlwan in Seongnam



Get there.



navigate

EUROPE

SUDDENLY, THE BOSSES ARE UP IN ARMS

Business is pressuring EU leaders—loudly—for economic reforms

Kee your head down. Speak softly. Go for consensus. Europe's chief executives have largely lived by those Milquetoasty precepts when it came to the delicate matter of dealing with its governments. Many a boss would say privately that he yearned for the marketplace freedoms that his peers in the U.S. enjoy. But to demand such freedoms from the great welfare states of Europe was simply not done. Occasional, private consultations with a Prime Minister or perhaps a finance ministry—that was possible. But blunt, in-your-face demands for change? *Jamais*.

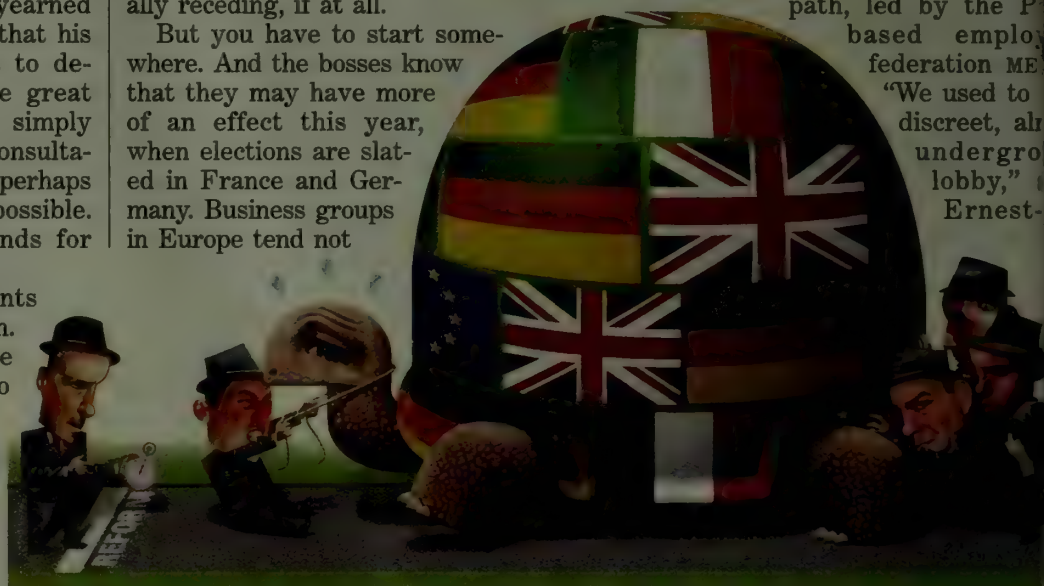
That's why January's events stand out so sharply. In a Jan. 14 open letter to Spanish Prime Minister José María Aznar, who is beginning a six-month stint as president of the European Union, the leaders of powerful business federations such as the Confederation of British Industry, the German Federation of Employers, and Italy's Confindustria spell out some bitter truths. Europe is falling far short of its potential, they say, and any idea that Europe's economies could drive world growth in their present state is a joke. "The very credibility of the process [to make Europe more competitive] is at stake," they add darkly.

Fighting words. And there are more to come. Across the Continent, business is mounting an unprecedented lobbying campaign to pressure leaders into moving on stalled reforms. Apart from the federations, the European Roundtable of Industrialists—a group that includes ThyssenKrupp, Telefónica, Saint-Gobain, and Nestlé—is also taking European governments to task. In a tough mid-January statement, the roundtable listed nine areas where it believes action must be taken, from liberalizing energy markets to eliminating tax obstacles on cross-border activities. "The urgency is now acute," says Daniel Janssen, chairman of Belgian chemical giant Solvay.

Can the bosses' revolt actually make a difference? Initially, it's hard to see what impact their ire can have. European executives operate under con-

straints that any American manager would find suffocating. Sky-high social security taxes, stiff workplace regulations, myriad trade impediments—all have been instituted by national governments for years and are only gradually receding, if at all.

But you have to start somewhere. And the bosses know that they may have more of an effect this year, when elections are slated in France and Germany. Business groups in Europe tend not



to support individual candidates or parties, but they can play a crucial role in commenting on the strength of a candidate's economic platform. Already, some top German CEOs such as Bernhard Scheuble of Darmstadt-based drug-maker Merck have hinted that they prefer the program of Edmund Stoiber, the conservative opponent to German Chancellor Gerhard Schröder in next fall's election.

Put simply, the bosses are speaking out because Europe just can't get on a strong growth track. The average growth of EU countries hit more than 3% in only one year out of the past 10. By contrast, the U.S. growth rate never fell below 3% during that period (except for last year). The result: By 2001, per capita gross domestic product in the EU was less than two-thirds that of the U.S.—the widest gap

since the 1960s. "Far from bringing to American levels, the European Union has left us farther behind," says Jan.

In an effort to help ignite growth, business groups are concentrating firepower to support EU President Prodi's ambitious liberalizing agenda at the Mar. 15 European summit in Barcelona. But the real problem is getting national governments to implement the fine words and promises. "When you have as business-friendly politicians in the last five years in this country as we have," asks Henri de Castries, CEO of Parisian insurance giant Axa. "Zero. Nothing."

Now French business is on the path, led by the Paris-based employment federation MEDEF. "We used to be discreet, although we were an underground lobby," says Ernest

WHAT EUROPEAN BUSINESS WANTS

- ▶ More liberal labor laws to make it cheaper to hire and fire workers
- ▶ Elimination of France's 35-hour workweek
- ▶ Significant cuts in corporate income taxes
- ▶ Deregulation of electricity and gas markets
- ▶ Pension reforms to slash costs and create Europewide rules

Seillière, MEDEF chief. "But the government absolutely has to institute change and that's why we want this discussion to be open."

German business is beginning to clarify its position. On Jan. 17, for example, the Federation of German Industries sponsored a tax forum attended by Finance Minister Hans Eichel. Federation President Michael Rogowski complained that tax reform didn't go far enough, embarrassing Eichel.

Schröder's people, business is ungrateful. "But the election will be decided by winning people, not lobbyists," says German Economics & Technology Minister Werner Müller. True, but working people depend on bosses for jobs, and those bosses are increasingly desperate for change.

By John Rossant in Paris, with John Ewing in Frankfurt



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Jan. 10th, 2:00-3:00 p.m.
Guy Kawasaki,
author and founder of
various PC enterprises

Topic: How To Drive Your
Competition Crazy



Jan. 17th, 2:00-3:00 p.m.
Watts Wacker,
best-selling author, political
commentator, and social
critic

Topic: A Visionary's
Handbook: Becoming Your
Own Futurist



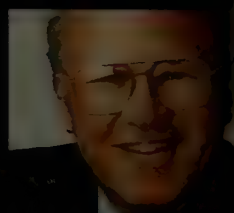
Jan. 24th, 2:00-3:00 p.m.
Roger Blackwell,
academician and
relationship marketing
expert

Topic: Relationship
Marketing



Jan. 31st, 2:00-3:00 p.m.
Gary Hoover,
requested speaker and
celebrated entrepreneur

Topic: The Power of Vision



Feb. 7th, 2:00-3:00 p.m.
Ken Blanchard,
coauthor of the
*One Minute
Manager Library*

Topic: Leadership for
the 21st Century

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- Inventive ways to strengthen your business relationships and expand your market share.
- The new do's and don'ts of successful leadership and management.
- Where business is heading and what you can do to ensure your future right now.



EDITED BY ROSE BRADY

WILL ZIMBABWE DRAG DOWN ITS NEIGHBORS?

A disaster is brewing in southern Africa. The once-prosperous nation of Zimbabwe faces intense turmoil in the weeks leading up to presidential elections scheduled for June 9. The ballot pits President Robert Mugabe, 77, who has ruled the country since its liberation from white rule in 1980, against Morgan Tsvangirai, 48, a former trade union leader who heads the opposition Movement for Democratic Change. Mugabe is doing all he can to ensure victory, from preventing young, urban voters from registering to inciting violence. Dozens of opposition supporters have been killed, while others have been beaten up or driven from their homes by backers of Mugabe's Zanu-PF party. "The election has every aspect of being stolen," says Chester Crocker, former U.S. Assistant Secretary of State for African Affairs. If that happens, it will be "a failure not only for Zimbabwe and South Africa [but] for Western policy." Mugabe, in contrast, characterizes his opponent as a puppet of Western imperialism.

If the tragedy were confined to Zimbabwe, it would be bad enough. Already many of Zimbabwe's 11 million people are going hungry, victims of Mugabe's economic policies. But the crisis is also producing a contagion effect in a region mired by poverty, a global recession, and the AIDS crisis. Refugees are pouring over Zimbabwe's border with South Africa, adding to that country's 40% jobless rate. Partly because of concerns about the widening crisis, the South African rand plunged 45% against the U.S. dollar over the past year. The international community, distracted for months by the fallout from September 11, is becoming increasingly alarmed. The European Union and the U.S. are now identifying the overseas bank accounts of Mugabe and his aides, preparing to freeze assets if the political environment doesn't improve. "We don't want sanctions to impact the people [be-

cause] so many are on the verge of starving," says Congressman Edward R. Royce (R-Calif.), chairman of the House International Relations subcommittee on Africa. "We want to send a message to those involved that they cannot launder money." The U.N.'s World Food Program is launching emergency shipments of maize, the local staple, to Zimbabwe. And South African President Thabo Mbeki and other regional leaders are calling on Mugabe to allow fair elections.

Yet it's proving difficult to curb Mugabe's excesses. Rejecting criticism, he has persisted with his controversial policy of confiscating without compensation land from white commercial farmers—a bid to gain rural voter support. Partly as a result, the economy shrank by 8% last year and could contract 5% in 2002.

If a free ballot were held, Tsvangirai might win. A poll late last year showed him ahead by six points. The former boss of the Zimbabwe Congress of Trade Unions, Tsvangirai is popular among educated, urban voters and has promised farmers compensation for their land. But electoral rules remain stacked against him. That's why longtime Africa observers such



MUGABE: Strong-arm election tactics

as Crocker think that if violence continues, Tsvangirai may drop out of the election and declare the ballot a farce, undermining Mugabe's legitimacy as a leader. That could put pressure on the president to resign. If the people come out into the streets, even the Army might urge Mugabe to step aside, Crocker says. "People power...is not to be dismissed," he adds.

At this stage, such an outcome seems a long shot. But many Africa observers predict more refugees, hunger, and a slump in regional investment if Mugabe wins another six-year term. For Mbeki and other southern African leaders, that could be a bigger test than anything they have yet faced.

By Iden Wetherell in Harare, with Stan Crock in Washington

GLOBAL WRAPUP

DIOS TO A LATIN TRADE PACT?

It doesn't look good for the U.S. effort to negotiate the Free Trade Area of the Americas (FTAA) pact by 2005, despite President George W. Bush's bid to reinject vigor into the hemisphere-wide trade talks in a Jan. 16 speech before the Organization of American States in Washington.

Latin governments are still stinging from the lack of attention the Bush Administration has paid to the region—even though the President promised to make this "the century of

the Americas." Argentina, having recently devalued its peso and defaulted on \$141 billion in public debt, is now closing ranks with Mercosur, the four-nation Southern Cone trade bloc. Dominated by Brazil, Mercosur has decried U.S. trade barriers and expressed little enthusiasm for the FTAA. "The FTAA is not going to be accomplished anytime soon, and even less now because of 9/11, Argentina, and the flatness of the U.S. economy," says George Grayson, a Latin American expert at the College of William & Mary.

Argentina's meltdown could also

fuel support for anti-globalization candidates in coming elections in the region. In Brazil, Luiz Inácio "Lula" da Silva, an opponent of free trade, leads polls for the October presidential elections. Ecuador, Bolivia, and Colombia are also holding ballots. Meanwhile in Mexico, political leaders who had hoped for a revamping of U.S. immigration policy now seem resigned to a relationship focused on border security issues. To many Latins, it seems that Bush—despite his words—is treating their region as an afterthought.

By Geri Smith in Mexico City

NOT-SO-SUPER AD SALES

Super Bowl spending has been hurt by shrunken budgets and the Olympics

Selling advertising for an annual TV extravaganza that draws 80 million-plus viewers might seem like easy labor. But when the final seconds tick off the clock on Feb. 3 in New Orleans to end Super Bowl XXXVI and the Most Valuable Player declares he's headed for Disney World, more than a few weary Fox Sports salespeople will likely wish they were heading for a vacation, too.

That's because they have had to work overtime to woo reluctant adver-

tisers in one of the driest ad climates ever. The Super Bowl is usually the biggest ad day of the year, but not this time. For some marketers, the recession has eroded ad budgets. For others, the Winter Olympics Games, kicking off on NBC less than a week later, have more allure. Demand is so tepid this year that the average rate for a 30-second spot has dropped for the first time, by 9%, to \$2 million, after doubling since 1996. Fox is even throwing in some extra goodies, such as

additional on-air promotions and sponsorships. Two weeks or to the game, Fox had about 10% ad time for the game itself left to but was still hoping to reach \$120 million in revenues.

Of course, this was one of the worst ad years in a decade. Total ad spend according to media-buying firm Universal McCann, plummeted 4% last year and is expected to post a meager gain of 2.4% this year, mostly on heavy buying in the third and fourth quart-



FEWER CORKS WILL BE POPPING AT THIS OLYMPICS

Salt Lake City should be party city for corporations bankrolling the Winter Olympics. The last Olympiad on American soil for at least the next decade seems like the perfect occasion to pamper key clients and reward top-notch employees.

Make no mistake: Booze will flow, tables will groan with lavish spreads, and the hospitality show will go on. But because of a lagging economy and the effects of September 11, the corporate schmoozathon on the slopes won't be what it might have been.

"The number of hospitality events is down significantly," says Bob Williams, president of Burns Sports & Celebrities Inc., an Evanston (Ill.) agency that supplies athletes for corporate clients. And so is the call for former Olympic heroes. Stars such as figure skater Peggy Fleming and speed skater Bonnie Blair are still in demand, though "it's not like previous Olympics in the U.S., when corporations had much larger

or unlimited budgets," says Williams.

How the slower-than-expected party scene will affect the overall success of the Winter Games is "the great unknown at the moment," says Thayne Robson, a University of Utah professor who is advising the Salt Lake City Olympic Committee on the economic impact of the games. "People who collect taxes, units of government that provide services—they're all

concerned about total revenues."

Some signs are ominous. Max Turner, president of Cuisine Unlimited catering service, which is preparing food for 12 different corporate clients during the games, says she has seen companies cut their guest lists by a third, though in the final days, she is adding back names. "It is still possible to get a hotel room here," says Turner. "The town is not sold out." In fact,

NOT EVERYONE IS PINCHING PENNIES

Sports Illustrated will entertain 800 key advertisers and marketers during the Olympics for an average stay of four days. Says publisher Fabio Freyre: "Our guests go behind the scenes, get the best seats, and go to the best parties. Yes, swimsuit models have been known to appear at our parties."

EACH GUEST RECEIVES

- ▶ Accommodations at a Marriott hotel
- ▶ Tickets for two events each day
- ▶ A gift duffel bag containing a backpack, sweatshirt, fleece pullover, ski turtleneck, scarf, base layer, set of Olympic pins, ski helmet, Nike watch, and Power Bars, among other items
- ▶ Entrée to Sports Illustrated's hospitality center at historic Union Pacific Railroad Depot
- ▶ Admission to a big party at "Club Splash"

again, no year could beat 2000, when 17 dot-coms bought Super Bowl on ABC, a few paying as much as \$3 million for 30 seconds. A year later, only one dot-com returned. "The game is trying to recover from the tech bubble bursting," says Mel Berning, president of U.S. broadcasting for media buyer MediaVest. Many advertisers are waiting until the last minute to get the best price. "No one is rushing to get the first this year," says Carolyn Peters, president of media buying firm Initiative Media North America. Even though rates are down this year, price inflation over the past five years has some advertisers wondering whether the Super Bowl is their best bet, especially when the premium they pay for that one Sunday game over a regular prime time show is 75%, vs. just a decade ago. "For the vast majority of advertisers, that's just not the way brands are built anymore," says John Pettit, president and CEO of brand consultant Sterling Group. "To concentrate that amount of money in one event" forecloses other campaigns. Another anomaly: The terrorist attacks on September 11 delayed the National Football League season by a week. That pushed the Super Bowl back to Feb. 3, closing the gap between the game and the start of the Olympics in Salt

SUPER BOWL INFLATION? NOT THIS TIME

Demand is so tepid this year that the average cost of a 30-second spot has dropped for the first time, after doubling from 1996-2001

AVERAGE AD RATE
PER 30-SECOND SPOT
(MILLIONS)

1996	COWBOYS VS. STEELERS, NBC	\$1.1
1997	PACKERS VS. PATRIOTS, FOX	1.2
1998	PACKERS VS. BRONCOS, NBC	1.3
1999	FALCONS VS. BRONCOS, FOX	1.6
2000	RAMS VS. TITANS, ABC	2.1
2001	GIANTS VS. RAVENS, CBS	2.2
2002	TO BE DETERMINED, FOX	2.0

Data: Nielsen Monitor Plus, Carat USA

Lake City on Feb. 8. EDS, Volkswagen, and Nike, unwilling to fork over for both events, opted for the Olympics. Allstate Insurance Co., too, made a major Olympics commitment, buying more than 50 spots aimed at viewers who may not be football fans. "The Olympics get you an association with the premier event not just in sports but in entertainment," says Robert S. Apatoff, Allstate's senior vice-president and chief marketing officer.

It's also a more attractive buy for advertisers looking to target women, a

big audience for the skating events that will air for 10 nights during the 17 days of coverage. Randy Falco, chief operating officer for NBC's Olympics unit, says most advertisers are buying ads in packages across the network and its cable channels MSNBC and CNBC, which will also broadcast some events. "Advertisers get more bang for the buck," says Falco. Two weeks before the Games, NBC had sold about 97% of its Olympic ad inventory, at an average \$600,000 per 30-second spot—already closing in on its goal of \$720 million in revenues for Salt Lake City, Falco says.

Still, some of the old Super Bowl reliables are back, such as Anheuser-Busch, PepsiCo, and General Motors. Universal theme parks, taking aim at rival Walt Disney Co., is buying its first Super Bowl ad ever, a 60-second spot in the third quarter costing \$3 million. Some such as Visa are so flush they're spending on both networks. "It's wonderful, as a leading brand, not to have to make decisions among these," says Nancy Friedman, Visa's vice-president for advertising. But for other recession-battered marketers that have to choose, the Super Bowl isn't the must-buy event it once was.

By Tom Lowry, with Gerry Khermouch in New York and Ronald Grover in Los Angeles

to go before opening ceremony on Feb. 8, about 1,000 hotel signs, says Jason Mathis, a spokesman for the Salt Lake City Convention & Visitors Bureau. Hospitality junkets can be lavish and the affairs (table), which explains why companies limit their invitations to a hundred VIPs. Standard offerings include round-trip airfare, a posh stay of three or four nights, and ticket-bought-after events—a package that cost \$18,000 per guest when rates are half a world away.

For games on U.S. soil, cheaper travel can cut that price by two-thirds. But adding to the tab for corporate hosts and giving pause to even the most care-free revelers are security concerns. Many corporations will issue photo IDs for their guests. And local businesses supplying services for corporate affairs are putting workers through elaborate security checks, including fingerprinting. "Nine-11 has had a tremendous impact. Security measures will be very, very tight," says Turner.

It's mostly the struggling economy, though, that has companies skipping the jumbo shrimp. Xerox, a worldwide Olympics sponsor, reduced its hospitality budget and the number of customers it is bringing to Salt Lake City after it cut some 1,500 jobs last year. Bank of America and Qwest Communications also have

shrunk their programs, say industry sources. Neither would discuss their entertainment plans with *BusinessWeek*.

Of about 40 companies entertaining at the games, including McDonald's, Coca-Cola, Visa, Delta Air Lines, Marriott, and Sun Microsystems, most are counting their pennies. "We don't see clients backing off entirely. But they are cracking down on their budgets," says Jan Katsoff of SportsMark Management Group Ltd., a Larkspur (Calif.) company that orchestrates Olympics parties. "What I'm hearing is 'Let's hire Tara Lipinski, but for an hour instead of two,'" says talent booker Williams.

Still, *Sports Illustrated* has a guest list of 800, largely key advertisers. AT&T, which gives the red-carpet treatment mostly to business partners, will be entertaining about 200 execs. And General Motors Corp. will reward dealers who have beaten sales goals by giving them "a once-in-a-lifetime experience," says Matt Pensinger, GM's manager for sports marketing. Yes, Corporate America will party, but for the most part, it won't be that hearty.

By Mark Hyman

ON THE SLOPES: Snowboarding



HOW AMAZON CLEARED THAT HURDLE

To earn a profit, it cut costs and started growing again

When Amazon.com Inc. Chief Executive Jeffrey P. Bezos proclaimed a year ago that the money-losing online retailer would finally earn its first operating profit by now, almost nobody believed him. Instead, investors kept hitting the sell button, knocking the stock down 40%, to around \$10. Oops. On Jan. 22, the same day traditional retailer Kmart Corp. filed for bankruptcy protection, upstart Amazon shocked everyone by reporting not just an operating profit of \$59 million but also a net profit of \$5 million in the fourth quarter—no ifs, ands, or pro formas. Investors piled back in, sending the stock up 24%, to \$12.60. Crows Bezos: "It's a major turning point for us."

The bubbly CEO may be a perennial optimist, but he's not exaggerating. Granted, the surprise net profit came partly because of a \$16 million gain on foreign currency exchange, which might not happen again. And Amazon's net will lapse back into the red this quarter as holiday merchandise bills come due. Yet with operating profits more than 10 times expectations last quarter, there's no question the e-commerce bellwether hit a big milestone. Throwing off a recent slump in sales, which were flat in the third quarter, it hiked the top line by 15%, or triple analysts' expectations, to \$1.1 billion. Even more important, it earned a profit by getting the basics right: tangible operational efficiencies, heads-down cost-cutting, and savvy partnership deals with the likes of Toys 'R' Us Inc. and Target Corp. "Amazon is just a much more experienced retailer now," says analyst Safa Rashtchy of U.S. Bancorp Piper Jaffray. "They're finally going to see some benefit from that."

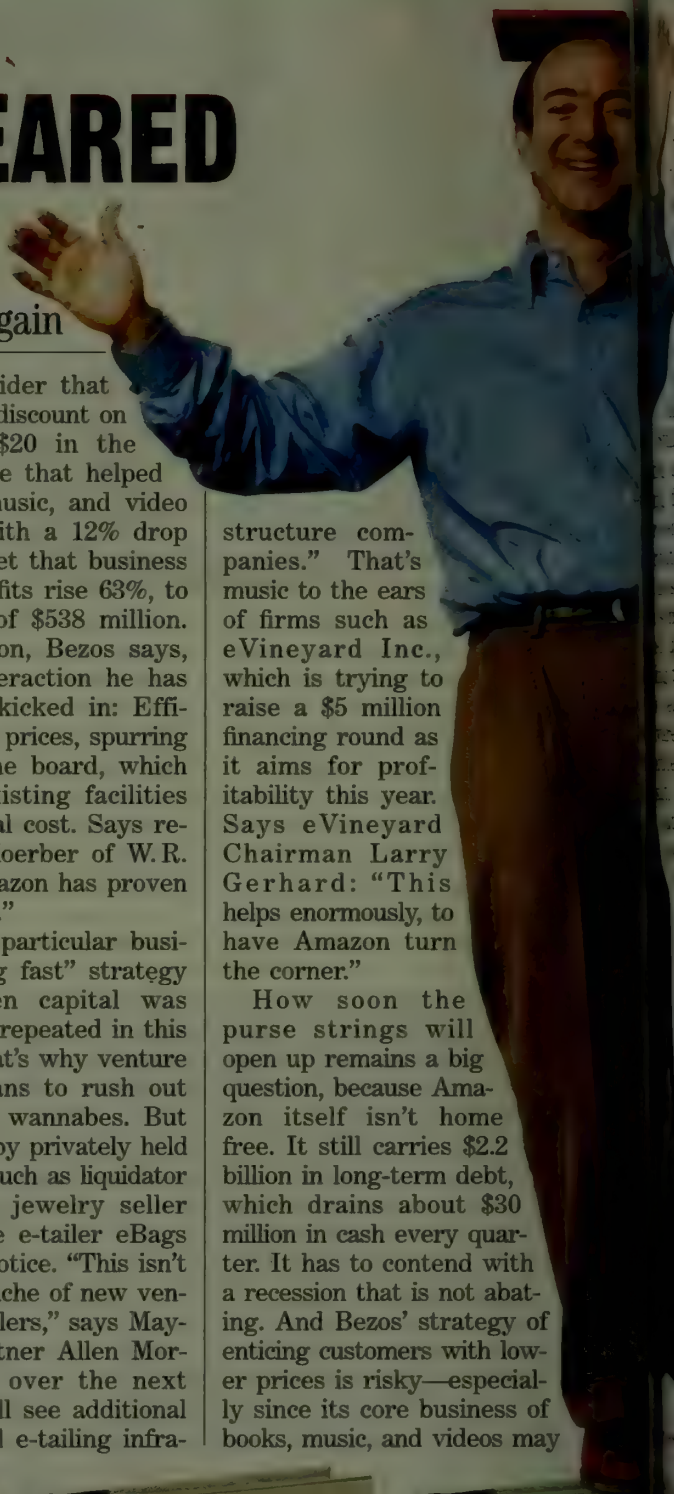
So might the entire e-tailing sector. Amazon's profit offers a strong signal that while online retailers may not turn the retail world upside down, they may well become a potent force in their

own right. How? Consider that Amazon offered a 30% discount on books priced above \$20 in the fourth quarter—a move that helped boost overall books, music, and video sales 5%, compared with a 12% drop in the third quarter. Yet that business still saw operating profits rise 63%, to \$64 million, on sales of \$538 million. That's a clear indication, Bezos says, that the favorable interaction he has always promised has kicked in: Efficiencies allow for lower prices, spurring sales growth across the board, which can be handled by existing facilities without much additional cost. Says retail analyst Kristine Koerber of W.R. Hambrecht & Co.: "Amazon has proven that e-tailing can work."

Oh, sure, Amazon's particular business model—a "get big fast" strategy forged in times when capital was cheap—won't likely be repeated in this penny-pinching era. That's why venture capitalists have no plans to rush out and fund any Amazon wannabes. But recent profits reported by privately held e-commerce companies such as liquidator Overstock.com, online jewelry seller Blue Nile, and luggage e-tailer eBags haven't escaped their notice. "This isn't going to start an avalanche of new venture investment in e-tailers," says Mayfield Fund general partner Allen Morgan. "But I do think over the next couple of years you will see additional funding in e-tailers and e-tailing infra-

structure companies." That's music to the ears of firms such as eVineyard Inc., which is trying to raise a \$5 million financing round as it aims for profitability this year. Says eVineyard Chairman Larry Gerhard: "This helps enormously, to have Amazon turn the corner."

How soon the purse strings will open up remains a big question, because Amazon itself isn't home free. It still carries \$2.2 billion in long-term debt, which drains about \$30 million in cash every quarter. It has to contend with a recession that is not abating. And Bezos' strategy of enticing customers with lower prices is risky—especially since its core business of books, music, and videos may



AMAZON.COM'S PUSH TO PROFITS

To achieve its first-ever net profit, the Web retailer honed its distribution operations and cut deals to boost revenues. Here's how it made the grade:

SORTING ORDERS

Fewer items were put in the wrong locations in its distribution centers, and it shipped 35% more units with the same number of workers as a year ago. That helped cut fulfillment costs by \$22 million last quarter, despite a sales increase of 15%.

ANTICIPATING DEMAND

Using software more accurately forecast purchase patterns by region. Amazon slashed inventory levels \$31 million, or 10%, in the fourth quarter.

BALANCING ACT: *Jeff Bezos calls it a "turning point"*

be maturing. Although international sales, largely of media products, jumped 81%, to \$262 million, too few customers are buying newer offerings in electronics, kitchen gear, and tools. Their combined sales fell 2% from a year ago as Amazon switched from selling some of the items itself to taking commissions on sales it handled for retailing partners.

Still, progress below the top line is piling up for all that. Most of all, it's coming from dozens of big and small improvements in Amazon's network of distribution centers, one of its biggest and most criticized expenses. A year ago, some 12% of incoming inventory ended up stored in the wrong place, leading to lost time and delayed orders. This year, thanks to better inventory management and smarter storage, that was reduced to just 4%. Partly as a result, even as sales rose 15%, Amazon cut fourth-quarter fulfillment expenses by \$22 million, or 17%, from a year ago.

Amazon also honed its process for sorting orders for multiple items—a skill it views as its essential edge as it keeps expanding its offerings and adding more retail partners that want to use Amazon's fulfillment capabilities. By reducing the time it takes to get all the items in an order into the sorting system, Amazon shipped 35% more units with the same number of people.

Says Lisa Rapuano, research director for Legg Mason Funds, whose market-beating value fund is the second-largest Amazon investor after Bezos

himself: "They have made incredible progress in operations."

At the same time, Amazon for the first time farmed out fulfillment of some books to its distributor, Ingram Book Group. Partly as a result, Amazon required 4,000 fewer distribution workers on its peak day, Dec. 11, compared with a year earlier. And with better planning and higher volumes, it could send more trucks directly to cities, bypassing the cost of regional postal sorting hubs and saving millions of dollars in the fourth quarter alone. Says Jeffrey A. Wilke, Amazon's senior vice-president of operations: "We spent the whole year really focused on increasing productivity without more capital spending."

Improvements aside, logistics experts estimate that Amazon's distribution cen-

tomers ordered something besides books, music, or videos in the fourth quarter; that's down slightly from 37% in the third quarter. Bezos says he hopes Amazon's just-announced offer of free shipping on orders over \$99 will entice customers to try higher-ticket electronics, tools, and kitchen gear. And analysts say its deals to run online stores for established brands such as Toys 'R' Us, Target, and Circuit City should get consumers more interested.

Indeed, those deals boost both the top and bottom lines. The retailers sell their products through the Amazon site and pay the e-tailer fees for handling distribution and customer service. Revenues for these services, which hit \$225 million in the fourth quarter, carry gross margins of at least 45%, nearly twice

DELIVERY Amazon's first-ever profit astonished analysts, but a huge factor was the dozens of improvements in how it handles the complex task of distribution

ters are still operating at less than 40% of capacity, half the most efficient level. "At this stage, it's overbuilt," says Richard W. Hallal, principal with Cleveland consultant Logistics Development Corp. So unless Amazon further reduces that capacity by shutting down more warehouses—a move not on its agenda—it must boost sales to maximize the use of its facilities. Although Bezos is forecasting at least 10% growth this year, it's unclear that rate will get operations chugging at optimal capacity.

One method of recharging sales growth is Bezos' much-criticized Wal-Mart Stores Inc.-style approach, adding everything from electronics to tools onto its original books business. Results are still mixed. Although some 35% of cus-

Amazon's retail margins. And the added unit volume helps fill up idle distribution capacity, making the e-tailer more efficient. Says analyst Ken Cassar of market researcher Jupiter Media Metrix Inc.: "The beauty of those two businesses—retail and services—is that they make each other stronger."

Even more lucrative and growing faster yet are Amazon's booming sales of used merchandise. That business made up 15% of unit sales from just 1% a year ago. Those sales carry even juicier 85% gross margins—the same kind of business that has made online auctioneer eBay the one remaining e-commerce darling among investors.

Is all that enough to restore luster to Amazon, which was once valued at more than \$30 billion? That will take longer, especially since its market valuation—now nearly \$5 billion—is rich next to traditional retailers. Bezos, too, concedes Amazon must continue to get many more small things right before he can build the huge, lasting company he's aiming for. "I don't think the next six years will be any easier," he says. No matter how far Amazon comes, it always seems to have a long way to go.

By Robert D. Hof in San Mateo, Calif., with Heather Green in New York

SHIPPING
Up 40% of ship-
s—up from zero a
ago—were consol-
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cities, bypassing
ost of sending
first to regional
al sorting facilities.
saved Amazon
ons of dollars in
ping costs.

FORGING PARTNERSHIPS
Deals to sell and ship
products for other
retailers such as Toys
'R' Us Inc. and Target
Corp. brought in \$225
million in revenue,
with gross profit
margins nearly
double Amazon's
overall 25% margins.

OPENING A MARKETPLACE
Allowing other sellers
to offer used books
and other merchandise
on Amazon.com
helped boost unit
sales in the holiday
season by 23%, to 38
million. Amazon's cut
of revenues carries
gross margins of at
least 85%.

LAWSUITS

HAS MICROSOFT MET ITS MATCH?

AOL could be the one company to offer it a real court battle

In the heavyweight slugfest between AOL Time Warner Inc. and Microsoft Corp., AOL usually gives as good as it gets. The one exception: Web browsers. AOL's Netscape browser is used by 21.4% of home users, while 89% use Microsoft's Internet Explorer. But what AOL hasn't won in the marketplace, it's trying to win in the courts. Piling on top of the Microsoft case being pressed by nine state attorneys general, AOL on Jan. 22 filed its own Microsoft antitrust action.

While AOL stands to gain from a court ruling that could bring billions of dollars in damages, it takes on risks as well. In court, Microsoft could turn the tables and accuse AOL of antitrust behavior. And, even if AOL wins, its declaration of war against Microsoft could provoke the software powerhouse to battle AOL even more ferociously.

Yet, it appears the rewards are bigger than the risks. In AOL, Microsoft faces a more determined foe than the Justice Dept., which signed off on a settlement on Nov. 2 that has been criticized as being too weak.

Vying with Microsoft for potentially huge emerging markets,

ranging from Web services to interactive television, AOL stands to gain both strategic advantages and a financial windfall with a courtroom win. "This is not someone whom Microsoft can buy off with a cheap settlement," says Edward J. Black, president of the Computer & Communications Industry Assn.

AOL has a strong case. Coming on the heels of a District of Columbia Court of Appeals ruling on June 28, 2001, which held Microsoft a monopolist in its actions against Netscape, AOL has had much of its work done for it. "AOL has a good chance of prevailing by piggybacking on the findings of the D.C. Circuit," says Alan J. Meese, visiting antitrust law professor at the University of Virginia.

If AOL wins, the spoils could be rich. In addition to the monetary damage award, AOL is seeking a ruling that could wind up requiring Microsoft to offer its Windows operating system without Microsoft's browser and other applications such as its instant messenger and its Passport personal authentication service. If Microsoft were unable to leverage its dominance in the PC operating system to take advantage of these new products, AOL's competing

services could get a big leg up. Microsoft scoffs at AOL's legal gambit as an attempt to gain advantage in the marketplace. Says Microsoft spokesman Vivek Varma: "This is just the next legal tactic in their business plan."

AOL, however, may not end up with much of an advantage if a judge requires Microsoft to unbundle its browser from Windows. The number of consumers who use Netscape's browser actually declined by 5%, to 15 million, between May and October last year, according to Jupiter Media Metrix. "The problem is the market has changed so dramatically [that] it's not clear a junction is going to change the position of Netscape and Microsoft browser at this stage," says Lawrence Lessig, a law professor at Stanford University.

What's more, AOL may be inviting antitrust trouble of its own. During trial, Microsoft could lob a counterclaim against AOL for behaving unfairly in markets it dominates. "AOL has not been labeled a monopolist so far, but that day may come," says Richard Doherty, director of research at Envisioneer Group. AOL rules the instant-messaging realm, with 41.7 million home users, 18.5 million for Microsoft. And AOL refuses to make its technology compatible with others.

While the payoff is uncertain for AOL, it's more likely to be rewarded than punished for seeking its day in court. Still, the suit raises the stakes in what is shaping up to be an all-out struggle for dominance of the next phase of the Internet.

By Catherine Yang in Washington with Jay Greene in Seattle

AOL'S LEGAL GAMBLE

By suing Microsoft on antitrust grounds, AOL Time Warner piggybacks on top of the government case against the software giant. But there are risks for AOL, too.

REWARDS

MONETARY DAMAGES AOL could win billions of dollars in damages, according to legal experts.

STRIPPED-DOWN WINDOWS A ruling in AOL's favor could force Microsoft to offer an operating system without its Internet Explorer browser and other applications AOL competes with.

A HARRIED MICROSOFT Another legal battle could distract the software giant when it's trying to launch new initiatives in Web services and the connected electronic home.

RISKS

INVITING ANTITRUST SCRUTINY

AOL may be faced with counterclaims by Microsoft that its online service unfairly monopolizes businesses such as instant messaging. AOL dominates that market and refuses to make its service compatible with other services.

GETTING IN MICROSOFT'S CROSSHAIRS

In the past, Microsoft has vanquished foes such as Lotus, Borland, WordPerfect, and Netscape. Now that AOL has essentially declared war, Microsoft may marshal its forces to beat AOL.

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Developments to Watch

BY ELLEN LICKING

PROTEIN ANALYSIS JUST GOT EASIER

TWO YEARS AGO, THE BIG buzzword in biotech was genomics. In 2001, it was proteomics—a fancy way of saying protein analysis. This year, new technologies should move proteomics beyond hype to practical reality. Two biotech companies—Cellzome of Heidelberg, Germany, and MDS Proteomics of Toronto—have developed highly automated methods for fishing large clusters of proteins out of cells and body fluids. Their studies appear in two independent papers in the Jan. 10 issue of *Nature*.

Until recently, scientists have had trouble analyzing the function of most proteins. That's because in many cases these compounds are difficult to obtain in quantity, and because they tend to carry out their biological tasks in combinations, or "complexes," of as many as 80 proteins.

The two *Nature* papers describe different ways to isolate and extract these complexes. Working with yeast, both groups were able to uncover hundreds of proteins that had never before been scrutinized. Using powerful computer programs, the groups were able to predict the functions of these proteins based on the kinds of complexes in which they were found.

This has important implications for drug research, says Giulio Superti-Furga, vice-president of Cellzome. Knowing a molecule's precise function will allow pharmaceutical companies to design safer, less toxic medicines.

A CHAIN DRIVE FOR THE WORLD'S TINIEST MOTORS

RESEARCHERS AT SANDIA National Laboratories have fabricated the world's smallest chain. The tiny silicon gizmo looks just like the chain on your trusty bike—but with a big difference: Each link measures a mere 50 microns long—half of the diameter of a human hair.

Ed Vernon, the micro-chain's designer, believes the invention could one day be used to power tiny camera shutters. It could also pro-



vide various gear ratios and linkages among hundreds of motors on silicon chips. Such chips—known in industry as microelectromechanical systems (MEMS)—are really machines that integrate minuscule motors, sensors, and other mechanical devices with computer smarts on slivers of silicon.

To build the micro-chain, the Sandia scientists piled five layers of silicon onto a slice of wafer three by eight millimeters. In each layer, they used photolithography and other chip-making techniques to print the next "floor" of the tiny high-rise structure.

HOW TO KICK CREEPY-CRAWLIES OUT OF THE BALLAST

THE BALLAST WATER OF international freighters is teeming with pesky critters such as green crabs from Europe and tubeworms from Australia. Once established in America's harbors, these invasive animals can quickly take over, killing many native species. Existing technologies to clean ballast water are expensive and potentially dangerous to crew members.

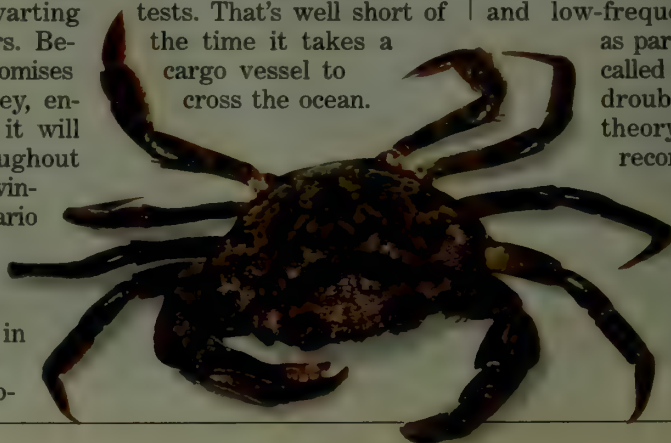
But a novel method devised to prevent ballast-tank corrosion appears to have the added benefit of thwarting hardy marine invaders. Because the technique promises to save shippers money, environmentalists hope it will be widely used throughout the industry. "It is a win-win solution," says Mario Tamburri, a marine ecologist at the Monterey Bay Aquarium Research Institute in Monterey, Calif.

Up until now, ship-

ping companies have used expensive paints to prevent ballast tanks from rusting. The new approach, developed by Sumitomo Heavy Industries, is to bubble nitrogen gas into the ballast water. This removes most of the dissolved oxygen, resulting in less rust. Tamburri estimates that shippers could save as much as \$100,000 per year per ship simply by switching over to this deoxygenation technique.

In the process, aquatic animals that are sensitive to oxygen levels are wiped out. Green crabs, for example, can survive only two or three days in low-oxygen containers, according to Tamburri's tests. That's well short of

the time it takes a cargo vessel to cross the ocean.



INNOVATIONS

■ In the wake of September 11 and the anthrax attack that followed, doctors and nurses are racing to educate themselves about the symptoms caused by microbes used as weapons. A Web site designed by researchers at the University of Alabama Center for Disaster Preparedness may help. The site offers interactive classes on six potential biological weapons, including anthrax, smallpox, and plague. The courses, which are free of charge, use case-based scenarios and photos to teach clinicians how to diagnose these rare diseases during their early stages. The Web address is www.biotech.ism.uab.edu.

■ A new mathematical technique could pave the way for sharper digital images and superior music recordings. Developed by math professors Akram Aldroubi of Vanderbilt University and Karlheinz Gröning of the University of Connecticut, the theory will help engineers come up with algorithms to convert analog waves—the sounds and signals of the world around us—into the zeros and ones of digital electronics.

With traditional techniques for translating analog to digital, the original signals may be "band-limited," meaning engineers must define a limit on how much of an image or a sound they wish to capture. Digital audio recordings, for example, discard high and low-frequency sounds

as part of a process called sampling. Aldroubi says the theory will enable a recording device to capture richer information and reduce signal loss when the material is compressed.



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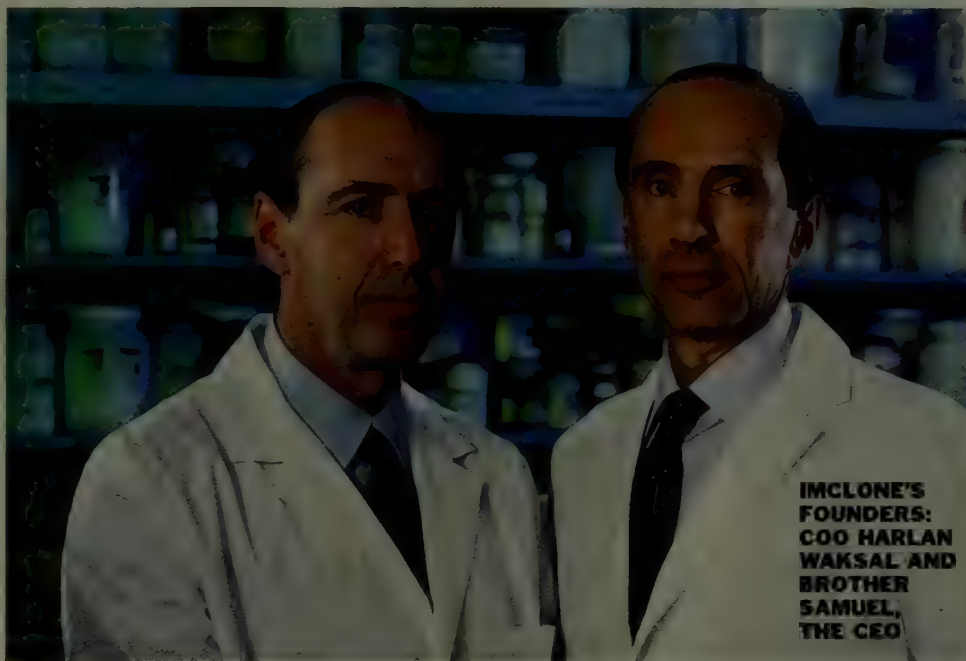
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PHARMACEUTICALS

A REAL BLOWUP IN BIOTECH

ImClone was flying high until it ran afoul of the FDA



IMCLONE'S
FOUNDERS:
COO HARLAN
WAKSAL AND
BROTHER
SAMUEL,
THE CEO

Is ImClone Systems Inc. another Enron? After all, damaging disclosures about the high-flying biotech company's new cancer drug directly contradicted statements by its CEO. The stock nosedived, from \$75 a share to \$20 in the past month, after top executives made multiple millions by selling their shares near the peak. And on Jan. 18, the same congressional committee that's investigating Enron Corp. announced it is looking into the ImClone mess. On top of all that, the companies share a director, Dr. John Mendelsohn, president of MD Anderson Cancer Center in Houston and creator of the ImClone drug.

Here, however, the resemblances end. Far from being a showcase for accounting trickery, ImClone is a case study of the risky business that is biotech—and the arrogance and possible incompetence of a management team that underestimated those risks. In biotech, such failings aren't unusual. In the first two weeks of January, eight other biotech companies saw their stock prices tank after setbacks to key drugs. But because ImClone's Erbitux looked to be the most important new drug approval

of 2002, its decline is the most dramatic.

ImClone still has one key factor in its favor: Virtually no doctors familiar with the drug call it a failure. "If you talk to the oncology community, the people who use it in trials for head and neck cancer will say this drug works," says Dr. Ronald Garren, publisher of the *Biotech Insight* investment newsletter and an

“We thought any questions [the FDA] might have we could answer during the review process”

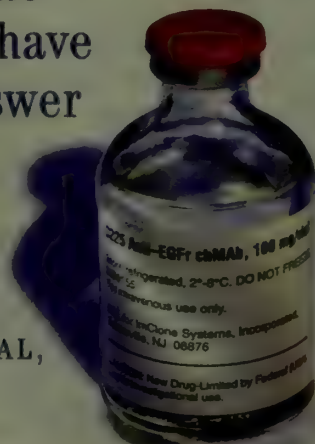
— SAMUEL WAKSAL,
ImClone Systems

oncologist who was involved in an erbitux head and neck trial.

Also, no one is questioning the reputation of the doctors testing the drug. "These trials were conducted by leading cancer centers in the world, the leading investigators in the world," says Gruntal & Co. analyst Cory L. Parov. The lead physician in the cancer trial submitted to the Food and Drug Administration, Dr. Leonard Saltz of Memorial Sloan-Kettering Cancer Center in New York, developed a standard chemotherapy treatment for colon cancer used around the world, commonly called the Saltz regimen. To protect his objectivity, Saltz from the start has refused to own ImClone stock.

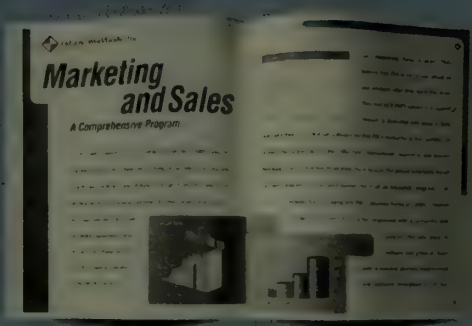
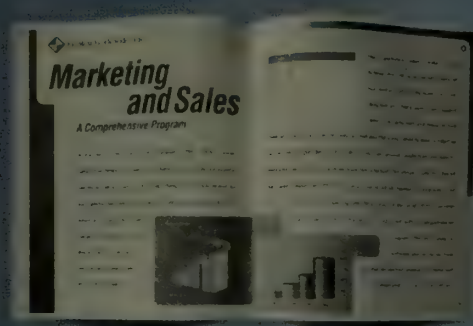
In order to guard trade secrets that may be privy to, the FDA does not comment on products it is considering. But the companies that make them. But much of the past year, Erbitux' effectiveness has been praised by the cancer research community as the harbinger of a revolution in treatment—a shift toward targeted therapies that home in on cancer cells without harming healthy tissue. In preliminary clinical trial results reported by Saltz last May, 22% of colon cancer patients who had failed all other treatments responded to a combination of Erbitux and chemotherapy. Based on those results, the FDA granted Erbitux expedited review status. The data looked just as promising to Bristol-Myers Squibb Co.: In October it paid \$1 billion—\$70 a share—for a 20% stake in ImClone.

These facts are well-established, but the intentions of ImClone CEO Samuel Waksal and his brother, COO Harlan Waksal, are harder to pin down. The company rushed to file a new drug application last year based on Saltz's second-stage clinical trial, although the drug requires three stages of trials for most drug approvals. When the FDA announced on Dec. 28 that it would accept ImClone's application, Sam W



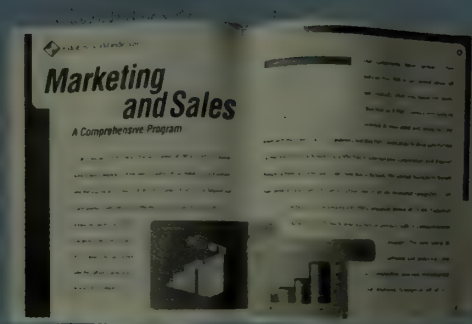
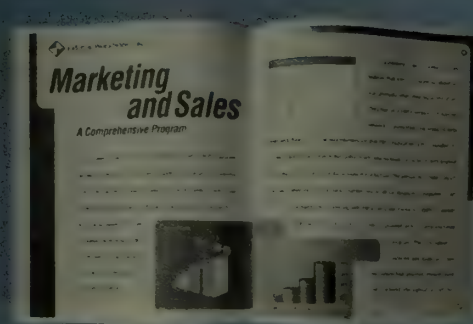
IMCLONE IN THE TANK





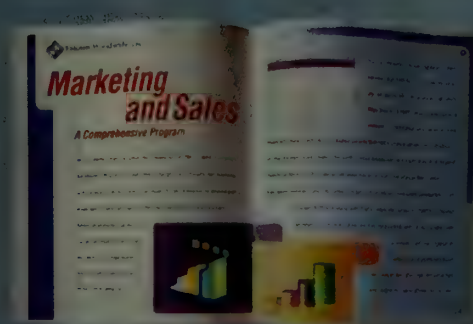
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sal said he was as shocked as the company's investors. This even though the agency had apparently been telling ImClone for months that it was concerned about the structure of the Phase 2 trial. "We thought any questions they might have we could answer during the review process," says Waksal.

Bad assumption. But it's not an unusual one, according to FDA staffers who decline to be quoted. They complain that drug companies often turn in sloppy applications. Indeed, many a drug review has been delayed because the FDA asked for more data. However, it is unusual for the application filing itself to be refused.

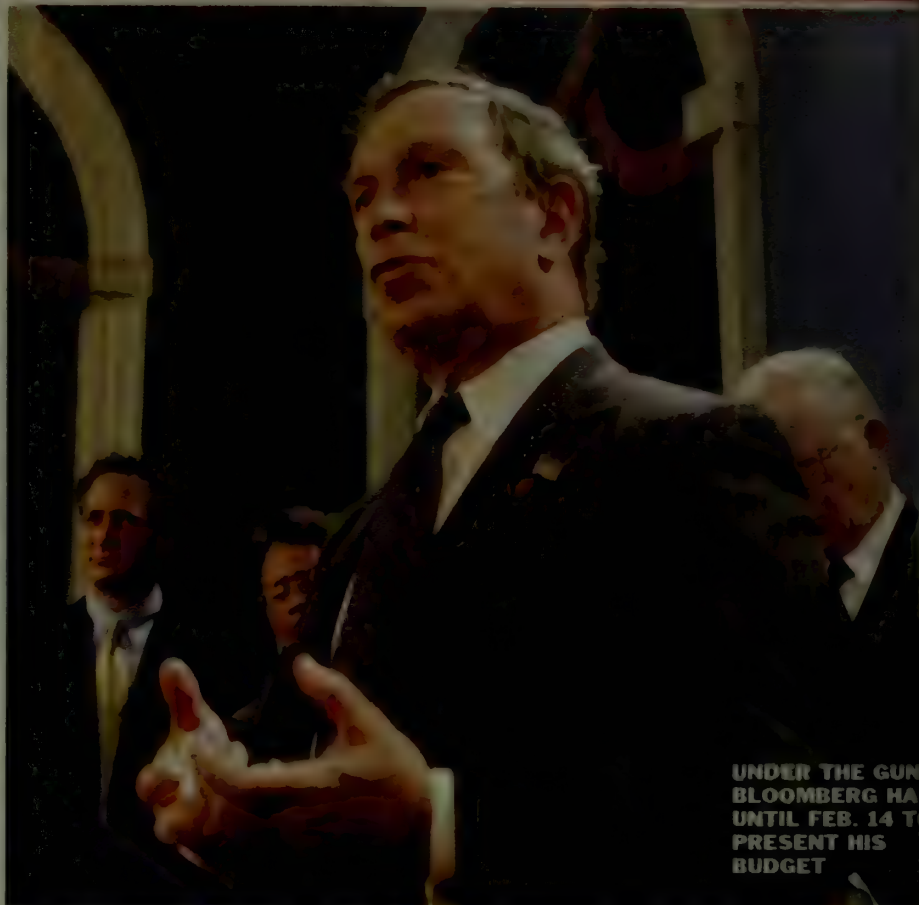
Waksal says the FDA wants more information on how doctors determined that the patients in their trials couldn't be helped with standard chemotherapy alone. That information is available, he says, but the company deemed it unnecessary to include it in the application. Wall Street now wants to know why he would think that. Waksal's judgment and credibility came under withering scrutiny when the FDA's letter detailing the reasons it refused the application was leaked to an industry newsletter. That missive, as reported in *The Cancer Letter*, stressed the need for thorough documentation of the treatment history of each patient. Plus, it said the clinical trial was not "adequate and well-controlled," even though Waksal had told analysts and reporters that the FDA had signed off on the trial. More worrisome still, the agency suggested new clinical trials might be needed to determine if Erbitux works on its own.

On this final point, though, it is the FDA's stance that doctors find worrisome. Erbitux was designed from the start to be used in combination with chemo, on the theory that the two together would work better than either one alone. Granted, a small trial of the drug as a stand-alone treatment reportedly had a response rate of 10.5%, high for a cancer drug. But that's still much lower than the 22.5% response rate when Erbitux is used in combination with the drug irinotecan. "The FDA usually insists that a drug show single-agent activity, but a lot of these new [cancer therapies] aren't designed to do that," says Garren.

Ultimately, most industry analysts believe Erbitux will be approved, though perhaps not in 2002. ImClone will meet with the FDA—most likely in late January—to discuss the problems with its application, and there is a faint hope that the problems will turn out to be easily remedied. But whatever happens, Waksal seems destined to put in an appearance in the chief executive Hall of Blame.

By Catherine Arnst in New York

Government



UNDER THE GUN
BLOOMBERG HAS
UNTIL FEB. 14 TO
PRESENT HIS
BUDGET

NEW YORK CITY

A DAY LATE AND \$4 BILLION SHORT

Falling revenues and high debt box in Mayor Bloomberg

Michael R. Bloomberg proved his savvy by building a multibillion-dollar financial information business amidst the smartest people on Wall Street. That feat earned him the luxury of spending \$72 million to be elected mayor of New York City. He campaigned on the strength of his financial experience, saying it made him the most qualified to manage the city through a recession and one of its worst budget problems in more than two decades.

That campaign boast will now be put to the test. For Bloomberg, the problems of running the aging metropolis may prove more difficult than any management and financial challenge he ever faced at Bloomberg LP. Although still in his first month of office, Bloomberg has already learned one hard lesson in his crash course on city finance: Cam-

paign vows to fore swear new debt have to be broken. "The challenge has financially is incredible," says for three-term Mayor Edward I. Koch.

For starters, New York City's budget for Bloomberg's first full fiscal year is short by \$4 billion of the \$27 billion planned city spending. While the total budget, including state and federal programs, comes to \$40 billion, the mayor's portion is 15%. That's the biggest percentage shortfall for new mayor since the city's fiscal crisis in 1976, when it arranged emergency borrowing for 19% of its annual expenses. What's more, tax revenues are expected to fall by 5.7% in the current fiscal year.

At the same time, debt-service costs for capital spending are now consuming one-sixth of tax revenues. City officials say for each New Yorker is up to \$4,

highest per capita of 15 major U.S. cities. Of course, the terrorist destruction of the World Trade Center—for which the city expects the federal government to pay billions—aggravated economic woes. But the problem dates September 11 and its psychological scars. Indeed, it's the national recession and bear market on Wall Street, a vital source of revenue, that will have the greater impact. Even if the economy begins growing again this summer, as some economists are predicting, revenue won't come back to 2000 levels by 2003, according to the city's Independent Budget Office (IBO). The mayor has until July 14 to present his budget for the fiscal year beginning on July 1. The deadline has already been extended to the end of January, and the City Council to the end of February. Bloomberg more than made his job to sort out the steps he has to take, primarily cutting payroll and stalling capital spending. Bloomberg required by law, passed in the aftermath of the 1970s' fiscal crisis, to balance spending with revenue by the end of each fiscal year. For the first time, Mayor Abraham Lincoln and Koch together had six years to close the 19% gap from the fiscal crisis. Bloomberg should be given an extra year "to spread the pain," says Koch. The coming \$4 billion shortfall casts a shadow on former Mayor Rudolph W. Giuliani's reputation for fiscal prudence. True, in his first term, 1994-98, Giuliani cut payroll and reduced spending, adjusted for inflation, by 1.8%. And he started pruning employment in his final months and set out a gap-closing program of \$1.3 billion. That move means leaving Bloomberg a balanced budget, plus \$500 million toward next year, according to the IBO. But two-thirds of those measures won't carry over into Bloomberg's first fiscal year. What's more, Giuliani's second term, real spending rose 11% over the eight years, according to the Citizens Budget Commission (CBC), a private research group—a figure Giuliani's budget director, Adam L. Barsky, calls an "exaggeration." And the work-

force increased to 250,000, some 6,600 more employees than when he took office. While the hiring seems justified—teachers and police were added as the population grew—the payroll is Bloomberg's burden now.

If he chooses, Bloomberg might be able to find about \$1 billion of wiggle room in the budget, including some refinancing and other maneuvers. And he is pursuing productivity gains from work-rule changes in labor negotiations this year with teachers, cops, and other municipal workers. But those gains are mostly for the future. Right now, he has to find \$3 billion in payroll cuts, which he

comptroller. Giuliani planned for even more spending—as much as \$14.1 billion over the next two years. That would drive debt to more than \$50 billion in 2004, according to the comptroller. Much of the debt buildup was to reverse the neglect of the city's schools and to pay for federally mandated water-filtration plants. But Bloomberg has no choice but to start paring back, says Charles Brecher, research director at CBC.

Will Bloomberg insist on the kind of draconian cuts he might make in his privately held financial-data empire? Four months before he took office, the candidate criticized budget gimmicks and swelling city borrowing. He complained that the city had "circumvented" a debt limit by creating a new bonding entity, the Transitional Finance Authority (TFA). He also slammed "one-shot revenues, especially those that come from the sale of city property," to balance the budget.

But by October, his tone was already softening. Instead of reining in debt, he said in a position paper, the city should borrow more through the TFA and create a new entity that would issue debt to finance a subway extension to the Jacob Javitz Convention Center. And instead of lamenting the "one-shots," he recommended the city think about selling its buildings to private investors and lease them back.

Bloomberg spokesman Jordan Barowitz says the impact of September

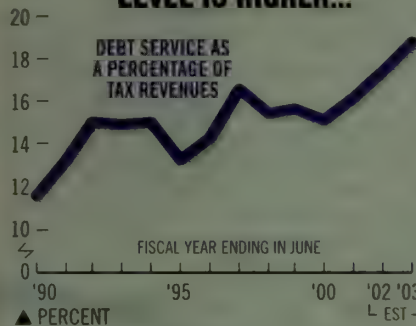
11 forced the new mayor to become more flexible. Now, says Barowitz, "everything could be part of the solution." So far, Bloomberg has asked city departments to propose 20% cuts in operating expenses and 25% cuts in capital-spending plans. And he has backed away from Giuliani's push for new sports stadiums.

Giving in on fiscal absolutes may be part of the education of any new mayor. After all, what good is a harshly balanced budget if it stains the city with a costly reputation for dirty streets, iffy transit, and crumbling schools? But such rationales can also become the start of a slippery slope of spending.

By David Henry in New York

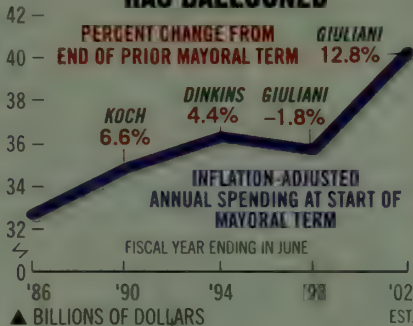
THE HOUSE THAT RUDY BUILT

NEW YORK CITY'S DEBT LEVEL IS HIGHER...



Data: New York City Office of the Comptroller

...AND THE BUDGET HAS BALLOONED



Data: Citizens Budget Commission

is starting, or in taxes, which, he said at his inauguration, "we cannot raise."

A huge constraint is the city's \$41 billion debt, money borrowed to build schools, housing, and bridges. Debt service this year will eat up about 17.5% of city tax revenues. That's up sharply from 11.6% in 1990. Little can be done to reduce the payments significantly—the state constitution and federal law, intended to prevent reckless tax-exempt borrowing, severely limit refinancing.

In fact, Bloomberg will have trouble keeping the debt from getting heavier. Before September 11, the city committed to \$6 billion in capital spending, up 60% from 2000, according to the city



COMMENTARY

By William C. Symonds

WHY TYCO QUIT DEALMAKING

The sudden about-face of L. Dennis Kozlowski, chief executive of Tyco International Ltd., is striking evidence of how radically the business landscape has shifted since Enron Corp.'s collapse. Only last May, as he was putting the finishing touches on his \$10 billion takeover of CIT Group, Kozlowski said that he was just getting started. He figured he would easily do another \$50 billion worth of deals in the coming five years. Ultimately, he told *BusinessWeek*, he hoped Tyco would "become the next General Electric."

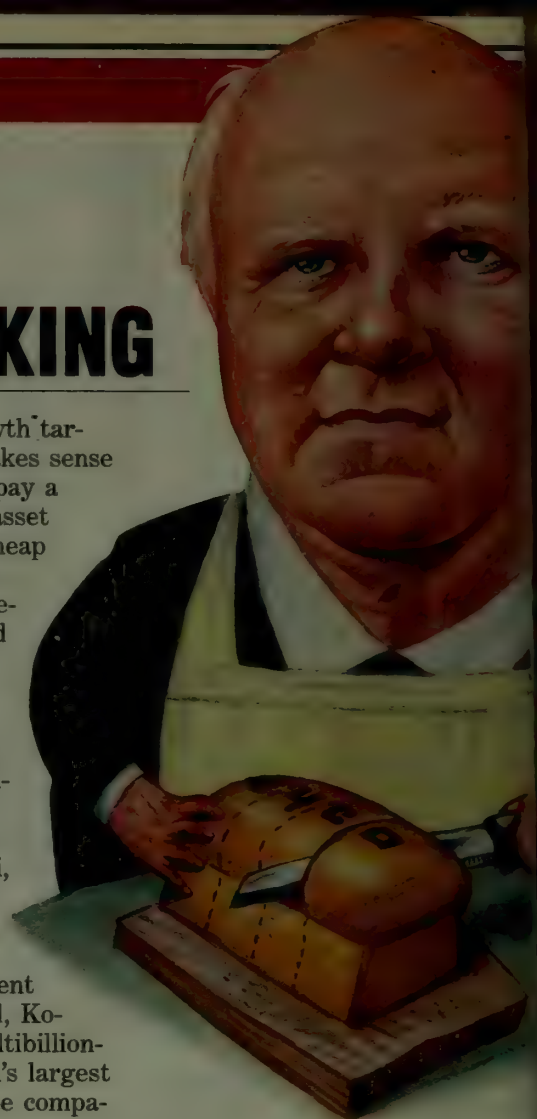
But on Jan. 22, Corporate America's most aggressive dealmaker announced a shocker, laying out plans to dismantle the empire he built over the past decade with \$62 billion worth of deals. By yearend, Kozlowski, 55, hopes to sell Tyco's plastics business to reduce debt, while splitting the rest of his \$36 billion conglomerate into four separate, midsize companies.

Why quit now? The short answer is that Tyco's gunslinger has run out of ammunition. His stock has tumbled nearly 25% since the end of last year and now trades at just 12 times this year's expected earnings—a huge 50% discount to the multiple accorded the Standard & Poor's 500-stock index. So, Kozlowski would have found it hard to keep forking over paper for new purchases, mak-

ing it difficult to meet his growth targets. "A company like Tyco makes sense when the market is willing to pay a premium over the underlying asset value, since that gives you a cheap currency for acquisitions," says Robert Monks, the famed shareholder activist who once served on Tyco's board of directors.

For years, it didn't matter to most investors whether they could figure out how Kozlowski was squeezing out double-digit growth from such mundane products as syringes and fire sprinklers. "Kozlowski, like [former General Electric CEO] Jack Welch, was defying gravity," says Michael Useem, professor of management at the Wharton School. Indeed, Kozlowski knit together such multibillion-dollar pieces as CIT, the nation's largest independent commercial finance company; AMP, a leader in electronic connectors; and ADT, the world leader in home security.

But with all the additions, it became nearly impossible to get an apples-to-apples comparison of Tyco's results over time. And now, post-Enron, investors aren't willing to stomach stocks that seem based on faith. Kozlowski may have built a GE-like conglomerate, but he nev-



er won the kind of credibility enjoyed by Jack Welch. True, he beat back critics, but an analyst set off a storm of stock-seller attacks in October, 1999, with allegations that Kozlowski had pumped up earnings by counting gimmicks. In mid-2000, the Securities & Exchange Commission launched an intense review without taking any immediate action. Tyco's shares quickly gained the ground they had lost, and Kozlowski resumed his dealmaking. Tyco's books remained a maze for the most persistent investors.

When Enron turned out to be a massive debt off its books, investors panicked and looked for other dominant companies. They zeroed in on Tyco. "They're playing games" with their numbers, charged Robert T. Meyer, forensic accountant at David W. Tice & Associates Inc., a analytical firm that first raised serious questions about Tyco's accounting. The run on the stock was remarkably short-lived, but this time, Kozlowski found that it was nearly impossible to combat rumors—regardless of whether the charges had any merit. Sources close to the SEC took the unusual step of issuing a report that the agency was launching a fresh probe of Tyco. It didn't matter. "When you don't fully understand something, you get a little worrier."

KOZLOWSKI'S PLAN FOR CARVING UP TYCO



FINANCIAL SERVICES

CEO: Al Gamper

REVENUES*: \$5.4 billion

EARNINGS*: \$1.2 billion

Provides financing for vendors, consumers, factors, and equipment deals



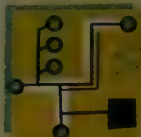
FIRE PROTECTION & FLOW CONTROL

CEO: Jerry Boggess

REVENUES: \$7.6 billion

EARNINGS: \$1.3 billion

Sells automatic sprinkler systems, and specialized valves



SECURITY & ELECTRONICS

CEO: Dennis Kozlowski

REVENUES: \$17.6 billion

EARNINGS: \$4.2 billion

Sells home and business security services and electronic components.



HEALTH CARE

CEO: Rich Meelia

REVENUES: \$7.1 billion

EARNINGS: \$1.7 billion

Makes syringes and other disposable equipment, wound-closure products, and imaging devices

*All financials are pro-forma company estimates for 2001

Data: Tyco International Ltd.

Charles L. Hill, director of research at Call Corp. "And you get even carried when you've just had the bankruptcy in history."

own statements were also raising questions of whether it could keep its pace. For the quarter ended Tyco had to make a huge restatement of earnings because of an accounting change that required the company to amortize earnings from sales of security systems over time, rather than at the time of sale. That resulted in a cumulative downward adjustment of \$654 million in earnings through Oct. 1, 2000.

Kozlowski was smart enough to realize the game was up. Still, a breakup seems unlikely to unleash the "50% upside" that he sees in Tyco's stock. It rose a paltry 2.4%, to \$47.55, on the day of the announcement, and fell anew by 5% on Jan. 23. "I

would not expect smooth sailing to successful execution" of Kozlowski's spin-off plan, warns Carol Levenson, an analyst at Gimme Credit, a research firm based in Chicago. A problem is that the managers named to run two of the Tyco—health care and fire protection—units—control—are almost unknown. It raises doubts about whether the company can raise enough money from public offerings to meet its retiring \$11 billion in debt. Critics point out that partial IPOs will effectively dilute Tyco's shares. Kozlowski is better off if he just sells some of the businesses to other companies.

Initially, Tyco should be relatively break up. It is highly decentralized, each of the individual businesses is capable of prospering on its own. The first to be spun off, was a company until last June. In fire, Tyco is the dominant player, and it is the world's second-maker of medical devices. And Kozlowski will remain as CEO of the most unit, the security and electronics

even if Kozlowski sticks around, the 2002 announcement marks a wind-down of one of the most extraordinary strategies of the past 10 years. An industrial conglomerate that was a high-tech star. In the new environment, it may be a long time before we see another empire on this scale. Investors today are demanding performance—they want to know what's behind it.

With Diane Brady in New York

WHAT TO LOOK FOR IN TYCO'S NUMBERS

For an exercise in mind-numbing complexity, there's little to compare with a Tyco International Ltd. financial filing. Take the quarterly press release the company issued from its official domicile in Pembroke, Bermuda, on Jan. 15. In addition to the usual operating earnings-per-share figures, Tyco highlighted two new accounting rules that had affected those numbers, detailed several hundred million in charges and credits, and a second set of pro-forma results. And that was just in the first paragraph.

With the conglomerate now planning to split into four separate units, is there any hope Tyco will become easier to understand? The company insists there will be more specific details available about each of the groups once they're split off. But that doesn't mean officials will be any more eager to explain the accounting behind the numbers. In responding to criticisms about Tyco's lack of detail in reporting new acquisitions, Chief Financial Officer Mark H. Swartz would only say his disclosure is already good enough. "We believe the disclosure we have is better than anyone's out there," he says.

There are plenty of reasons to watch closely as Tyco unwinds. Critics have long accused Chief Executive L. Dennis Kozlowski of using his confusing financials and an aggressive acquisition schedule to pump up earnings. One oft-repeated allegation is that the companies Tyco buys restate their results downward just prior to closing the deal. That way they immediately look better under Tyco's umbrella. Kozlowski has denied that he uses such tricks. Still, skeptical investors will want to scour Tyco's upcoming S-1 registrations. These will be filed with the Securities & Exchange Commission about a month before each of the three initial public offerings. The first deal, the spin-off of Tyco's financing business, is scheduled for March or April.

Count on Tyco to put its best foot forward, showing what are sure to be impressive pro-forma growth fig-

ures. But just as crucial will be examining each unit's debt level. Overall, Tyco's debt burden has been rising (chart). And in the past, some companies have used spin-offs to push a heavy debt load onto their departing divisions, notes Joe Cornell, principal of Spin-Off Advisors, a Chicago research firm. One incentive for Tyco not to do this is that it wishes to maintain its A credit rating for the new companies. Standard & Poor's has affirmed Tyco's rating for now, but says it's not clear if the security and electronics unit would get an A rating, given the cyclicality and higher risks of its businesses.

Tyco may also talk about each new company's interest expenses in the section, "Management's Discussion and Analysis." Comparing that number with operating cash flow should make clear how well the company can handle its debt.

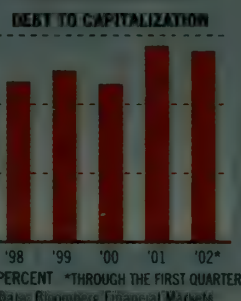
Another big issue will be the goodwill Tyco built up through its acquisitions. Now, Tyco and its finance unit together carry \$39 billion on their balance sheets to reflect premiums paid over the fair market value of the tangible assets bought. How that gets divvied up is key, says Lehman Brothers accounting expert Robert

Willens. Those allocations should accurately reflect the acquisitions that created each unit. To track acquisition costs, you must check historical filings. Critics take Tyco to task for attributing too much of its purchases to goodwill, lowering its expenses. So any changes in these numbers will be closely watched.

Some of the best information will be buried far down in the offering documents. Investors will want to pay close attention to any mention of changes in the company's accounting procedures or legal policies. "A lot of the juicy stuff would be in the footnotes," says Spin-Off's Cornell. And if the numbers still aren't clear, follow the Enron rule: If you can't understand it, you shouldn't own it.

By Nanette Byrnes, with Diane Brady, in New York

TYCO'S RISING TIDE OF DEBT



Source: Bloomberg Financial Markets

COMMENTARY

By Joann Muller

ATTENTION KMART: FIND A NICHE

Does America need Kmart? That's what really matters in the wake of the giant discount chain's bankruptcy filing on Jan. 22. Certainly, the opportunity for a swift financial makeover is a plus. By keeping creditors at bay, Kmart is free to close underperforming stores, walk away from bad leases, and trim debt. But what then? Unless Kmart Corp. can give consumers a good reason to shop at its stores, the once-mighty retailer will slide into oblivion.

There's little doubt that Kmart, based in Troy, Mich., will survive the largest-ever retail bankruptcy—at least for a while. But to thrive in the long run, it has to face some uncomfortable truths. First, it has to accept the reality that it has long since lost the battle with Wal-Mart Stores Inc. Its bigger competitor is both ubiquitous and light-years more efficient. Trying to compete on price last year was a colossal error. However much Kmart cuts prices, Wal-Mart can cut more. Kmart has to be more than a Wal-Mart wannabe if it wants to survive.

Second, a healthy Kmart very likely means a smaller Kmart. The discount store should close at least 250 of its 2,114 stores. Five hundred would be even better. Then it needs to carve out a niche between Wal-Mart and Target Corp., the purveyor of cheap chic. Most of all it has to capitalize on its urban locations.

CEO Charles C. Conaway laid out his vision for Kmart soon after arriving in June, 2000. His plan: to make Kmart "the authority for moms, home, and kids." But grappling with Kmart's myriad operational problems, from logistics to technology, has left precious little time for bonding with moms. To make his fuzzy description of the new Kmart mean something, Conaway must pump new life into tired apparel lines, such as the Jaclyn Smith and Kathy Ireland labels, and add more exclusive brands like Martha Stewart Everyday.



KMART SHOPS FOR A STRATEGY

Here's what the retailer must do to survive:

- Add full-line groceries to core urban stores
- Develop more unique brands like Martha Stewart
- Fix nagging supply chain problems
- Improve marketing, to give consumers a reason to shop

Kmart's best hope for survival lies in a core group of several hundred stores in urban areas, far from any Wal-Mart and Target outlets. "Their urban locations provide a level of convenience that's potentially unmatched," says Sanford C. Bernstein & Co. analyst Emme P. Kozloff. "Wal-Mart and Target won't go into those areas." Plus, she adds, Kmart has very low-cost, long-term leases on those stores. Kmart hopes to dramatically boost sales and profits at its urban stores by adding a full assortment of groceries—including fresh meat, produce, and bakery products—tailored to each community's ethnic mix. If Kmart executes

this play correctly, it stands a good chance of success.

But that's a big if. Kmart has been experimenting with food for a decade but has lacked the resources and the focus to make it work. Today it has just 124 supermarkets, compared with 1,066 Wal-Mart supercenters. That's one reason Wal-Mart zoomed past Kmart in sales. Shoppers visit supercenters two or three times a week, compared with three times a month for a typical discount store.

Here again, Kmart has to avoid the temptation to try to out-Wal-Mart Wal-Mart. In a hopeful sign, Kmart is dusting off a strategy cooked up four years ago that it never implemented. Instead of rolling out 140,000-square-foot grocery-discount-store combos, it is converting smaller stores to the Super Kmart format. The strategy makes sense for urban stores where real estate prices are high. At \$2.5 million to \$5 million per store, the conversion is a bargain, compared with the cost of building a giant new outlet.

But it's a balancing act. To shoehorn a full grocery into an existing Kmart, the company has to pare back on general merchandise. The trick is doing it so customers don't notice anything is missing. Done correctly, sales can actually increase, says

James Funk, a district manager in Michigan for Super Kmart. At one store in Bloomfield Hills, for instance, Funk cut the electronics department by more than 15%—and sales grew nearly threefold.

In neighborhoods starved for decent grocery stores, Kmart's urban supercenters could be a hit. But their success depends on flawless execution, something Kmart has not been known for. And it still has the rest of its stores to fix up. Clearly, Kmart has lots of work ahead before investors have something to feast on.

Muller covers Kmart from Detroit

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SHOULD YOU FOLLOW THE INSIDERS?

Mimicking their trades in company stock is no sure road to riches

Most surefire tips for beating the stock market have short lives. They fizzle out as soon as people figure out that there is no magic formula for making money from stocks. But one concept has had a remarkable run: shadowing the trades of those who have the inside scoop on a company—its executives and directors. A small industry of publications and Web services has sprung up to track their required disclosures to the Securities & Exchange Commission since the late-1990s tech boom, when stock became a key part of executives' compensation. It was not lost on the market at large that many people got rich by investing in their own companies. And all the publicity about prescient selling by Enron Corp. brass before the energy company's demise has given the idea a new push.

The idea has broad currency. Many mainstream publications cover the topic, including *BusinessWeek*, which prints data from *Vickers Weekly Insider Reports*. Numerous academic studies support the view that an increase in insider buying or selling across a sector tends to point to a switch in the market's direction. Insiders at tech and scientific companies in particular seem to have a much better knack for timing the market than ordinary investors. In the months before the Nasdaq hit its March, 2000, peak, techies were selling actively. Since then, they've sold into

shallow, short-lived rallies. A study by researchers from the University of California at Los Angeles and New York University shows that a group of insider buyers, most from tech and pharmaceutical companies, beat broad market indexes by an average of 9.6% in the six months following their purchases.

But for individual companies—which is what the bird-doggers really care

most about—there's little solid evidence that insider transactions convey useful information about the near prospects for a company's stock. A analysis by *BusinessWeek* of a series of trades shows why: Many factors, regulatory restrictions to the ebb and flow of executives' personal financial control the timing of an insider's trades and mask the motivations



ably, an executive who is buying is probably enthusiastic about his company's prospects, but a big repeat seller would be raising cash for a tuition bill at Harvard University or the downpayment on a ski lodge in Aspen, Colorado. And with companies paying an ever-greater part of compensation in stock options, insiders have more incentive to sell shares to cover expenses.

Besides, SEC filings on insider traders aren't disclosed to the public until several weeks after deals occur—when the optimum time to buy or sell may be past. In addition, brokers are increas-

Many insiders get it wrong. Yahoo's Koogle sold \$25 million worth of stock last year, much of it before the shares took off on a 65% rally

Studies, such as the one from UCLA and NYU, that appear to support investment strategies based on insider tracking turn out on closer analysis to be less-than-rousing endorsements. For instance, the reported 9.6% six-monthly lift was skewed by outside gains at a few companies. When researchers looked at all companies reporting insider trades, buyers only beat the market by 3.6% on average. And that average was also unrepresentative. In each case, only half of all insider buyers outperformed the market by more than a tiny margin. The study shows that investors would need to mimic hundreds of insiders' trades to lock in above-market returns, according to one of its authors, UCLA Assistant Finance Professor David Aboody. "You would need an insider fund. An individual investor would lose his pants," says Aboody.

Even those in the insider-tracking business are willing to acknowledge that their data are ambiguous at best. "You see investor services promoting that Bill Gates sold a large amount" of Microsoft stock, says Lon Gerber, research director at Thomson Financial/Lancer Analytics. "And it generally means nothing."

Indeed, even when executives call their company's stock just right, it's often as much dumb luck as anything else. That became clear in interviews with a number of insiders identified by Lancer Analytics as having had astonishingly prescient trading patterns over the past 15 years, measured by returns over the six months following their trades (table).

Consider the case of David M. Kies, a director of ImClone Systems Inc., a company whose shares plunged after a much-ballyhooed cancer drug failed to pass muster with the U.S. Food & Drug Administration. Kies bought ImClone shares 19 times after joining the board in 1996, and all but once, the stock climbed in the next six months. Last October, Kies made his first sale, at \$70, near the stock's high.

Nearly three months later, ImClone shares fell below \$20. A scared insider bailing? Hardly. Kies sold only 8% of his holdings into a \$1 billion tender offer by Bristol-Myers Squibb Co. to raise tax money. "If I didn't have the tax liability, I just would have held on," says Kies, adding that he's still a believer in the drug, even though "I can't say I fully understand the science."

The examples also show that many smart-looking buyers never sell—with unfortunate results. William A. Friedlander, a money manager who sits on the board of telecom carrier Broadwing Inc., made out fabulously for a while. After each of his 10 purchases, Broadwing shares rose an average of 23% in the following six months. The 24,000 shares he bought in July, 1999, at \$21 rose 80%. Friedlander still owned those shares at \$10. Why didn't he sell? He says he was mistakenly convinced that demand for broadband services would outstrip supply.

Others, like Paul A. Frame, simply got lucky. The CEO of oil services company Seitel Inc. sold shares that he had acquired earlier, mostly through options, over a decade on 16 different occasions—and in 13 cases the shares were down six months later. But, he says, he sold on a schedule determined by the company's restrictions on when he could trade, according to company spokesman Russell J. Hoffman.

Even many tech insiders get it wrong. Far from being the first to jump ship, Nortel Networks Corp.'s execs and directors bought 34 times in the months since October, 2000—a period when the stock plunged by 90%. At Gateway Computer Inc., insiders have bought a half-dozen times since mid-2001, but most did so long before Gateway released a weak sales forecast on Jan. 8, which pushed the stock down nearly 30% in one day. It has continued to fall. And Yahoo! Inc.'s ex-CEO Timothy A. Koogle sold \$25 million of Yahoo stock last year, much of it before the shares took off on a 65% rally.

The bottom line: Insider tracking is a lot of work, and it's hardly a sure-fire technique for making money. A pattern of buying or selling might give investors a hint that something's up at a company. But it's still no substitute for dogged research.

By David Henry and Timothy J. Mullaney in New York

INSIGHT OR DUMB LUCK?

BUYERS

	NUMBER OF BUYS	TIMES STOCK UP SIX MONTHS LATER	PERIOD
WING	10	7	1986-2001
A. Friedlander, Director: He never sold as the soared; stock is down 64% since Jan. 1,			
A	15	14	1987-2000
Friedson, CEO: Hasn't sold since '95, while tripled to \$36; stock is now at \$6.40			
KIE	19	18	1996-2001
Kies, Director: Sold 8% of his stake to pay before the shares fell 70%; stock is now uncloud due to a drug approval problem			
R	10	10	1996-2000
R. Sanchez, Director, Never sold as the stock ed past \$90; stock is now at \$5.15			

SELLERS

	NUMBERS OF SALES	TIMES STOCK DOWN SIX MONTHS LATER	PERIOD
me, CEO:	16	13	1991-2001
Lucky. Sold on company-restricted rule; stock is now a volatile market laggard			
NET	8	8	1994-2000
Greaves, Director: Sold heavily above \$29 the lost CEO job; stock is stalled around \$20			
Hendig, Senior VP:	12	11	1987-2000
Looks smart. Big sales in near stock peak; stock is now around \$10			

Data: Thomson Financial/Lancer Analytics; BusinessWeek

ly helping insiders camouflage their transactions by offering them private contracts to stop losses or secretly capture gains. Or they may help them schedule trades months in advance, a tactic permitted by a recent SEC ruling. Moreover, many companies, concerned about impressions of impropriety, limit when their execs can trade so they can't be the market.

FLASH PROFITS

A BIG CRIMP IN CASH FLOW

With the recession broadening, revenues are in free fall

Look out, investors: The recession is bodyslamming Corporate America in a new and troubling way. Not only are earnings falling but, for the first time in a decade, sales are dropping, too. Indeed, even though health-care companies and some consumer products firms booked double-digit sales gains in 2001's fourth quarter, overall revenues tum-

quarterly earnings. The villains: September 11, in part, but the bigger problems were slumping prices and collapsing demand in a slowing economy.

Despite the gloom for investors, there has been a silver lining for consumers. As companies have cut prices to generate sales, shoppers have been getting more bang for their buck. Just ask anybody who's bought a wildly discounted airline ticket or computer lately.

Of course, if sales continue to sag, the negatives will eventually outweigh the positives. Corporations will have less cash coming in to meet expenses, service debt, and invest in new ventures or gear. That could easily retard an economic recovery as companies cut costs and jobs further. "This is really worrisome," says Sung Won Sohn, chief economist of Wells Fargo & Co.

The fourth-quarter sales slump was sharpest among high-tech firms and old-line manufacturers, two industries already pum-

meled by the recession. Technology-sector revenues sank 20%, while sales by basic-materials producers were off 12%, according to estimates from Thomson Financial/First Call. Next in line were transportation companies, with sales down 11%.

But sales also declined at many service-sector businesses, indicating that the downturn broadened in the final months of 2001. And a large swath of the nation's blue-chip giants made the list of companies whose fourth-quarter revenues shrank: Alcoa, American Airlines, Citigroup, Duke Energy, DuPont, Exxon Mobil, Ford Motor, General



bled at an unprecedented rate.

How bad is it? Fourth-quarter sales of the 153 companies in the Standard & Poor's 500-stock index that have reported results are off 3.9% from a year earlier. That might not look like much compared with the expected 22.1% plunge in fourth-quarter profits among S&P 500 businesses or the 32% earnings dive in *BusinessWeek's* flash profit survey of 100 bellwether companies. But the revenue decline is almost four times the 1% decrease in 1991's fourth quarter, the last time aggregate sales slipped. It's also the biggest drop in the nearly 40 years that *BusinessWeek* has tracked

CURRENT QTR SALES

(MILLION)

INDUSTRIALS 320,720

ABBOTT LABORATORIES	4,445
AIR PRODUCTS & CHEMICALS †	1,316
ALCOA	5,181
AMERADA HESS	2,881
ARCHER DANIELS MIDLAND ††	5,554

BOEING	15,702
CATERPILLAR	5,096
COCA-COLA ENTERPRISES	3,967
CONAGRA FOODS ††	7,363
DELPHI AUTOMOTIVE SYSTEMS	6,380

DUPONT	5,229
EXXON MOBIL	47,300
FORD MOTOR	41,150
FORTUNE BRANDS	1,472
GENERAL DYNAMICS	3,508

GENERAL ELECTRIC	33,975
GENERAL MILLS ††	2,342
GENERAL MOTORS	45,950
HARLEY-DAVIDSON	911
INTERNATIONAL PAPER	6,254

JOHNSON & JOHNSON	8,403
JOHNSON CONTROLS †	4,817
KB HOME	1,450
MERCK	12,558
MINNESOTA MINING & MFG.	3,863

NIKE ††	2,336
PARKER HANNIFIN ††	1,437
PFIZER	9,030
PPG INDUSTRIES	1,907
SUNOCO	2,952

TYCO INTERNATIONAL †	10,068
UNITED TECHNOLOGIES	6,974
VISTEON	4,493
WEYERHAEUSER	3,398
WILLAMETTE INDUSTRIES	1,061

SERVICES 148,485

AMAZON.COM	1,115
AMR	3,804
BANK OF AMERICA	N/A
BEAR STEARNS	1,813
BEST BUY ††	4,756

BURLINGTON NORTHERN SANTA FE	2,301
CAPITAL ONE FINANCIAL	1,981
CARDINAL HEALTH ††	13,092
CARNIVAL	959
CIRCUIT CITY GROUP ††	2,279

CITIGROUP	26,650
COSTCO WHOLESALE †	8,466
COUNTRYWIDE CREDIT INDS. ††	1,720
CSX	2,009
DARDEN RESTAURANTS ††	1,013

FEDEX ††	5,135
GOLDMAN SACHS GROUP	6,118

Electric, IBM, Intel, International per, J.P. Morgan Chase, Lucent Technologies, Motorola, Sears, 3M, Weyerhaeuser, and Yahoo!.

Still, some sectors forged ahead. McKesson & Co.'s quarterly revenues were up 10%, while medical-products wholesaler McKesson Corp. boasted a 20% jump in sales. And Archer Daniels Midland Co.'s quarterly sales grew 12%. In these gains may not be repeated. M

PS % CHG.	REPORTED (11/15)	EPS	DIFF.	CURRENT QTR. SALES (MILLIONS)	% CHG.	QTR. PROFITS (MILLIONS)	% CHG.	EST. EPS (11/15)	REPORTED EPS	DIFF.	
-27	0.43	0.33	-0.10	HOUSEHOLD INTERNATIONAL	3,643.6	+11	548.9	+11	1.17	1.17	—
-19	0.52	0.39	-0.13	J.P. MORGAN CHASE	NA	NA	-332.0	NM	0.50	-0.18	-0.68
-16	0.54	0.52	-0.02	LEHMAN BROTHERS HOLDINGS	4,300.0	-33	130.0	-67	0.91	0.46	-0.45
NM	0.33	-0.17	-0.50	MBNA	NA	NA	524.8	+24	0.58	0.60	+0.02
-84	1.84	0.61	-1.23	MERRILL LYNCH	7,610.0	-35	-1,264.0	NM	0.52	-1.51	-2.03
+20	0.23	0.23	—	MORGAN STANLEY DEAN WITTER	8,218.0	-20	870.0	-28	0.67	0.78	+0.11
-75	0.85	0.12	-0.73	NORTHWEST AIRLINES	1,985.0	-27	-216.0	NM	-3.08	-2.55	+0.53
-37	0.77	0.48	-0.29	ROADWAY	867.5	-9	13.7	-46	0.75	0.73	-0.02
NM	-0.04	-0.08	-0.04	SCHWAB (CHARLES)	1,059.0	-21	-13.0	NM	0.08	-0.01	-0.09
-18	0.43	0.44	+0.01	SEARS, ROEBUCK	12,242.0	-1	494.0	+12	1.88	1.52	-0.36
NM	0.11	-0.23	-0.34	SOUTHWEST AIRLINES	1,237.6	-16	63.5	-59	-0.02	0.08	+0.10
NM	0.11	3.82	+3.71	ST. PAUL	2,388.0	+19	-718.3	NM	0.64	-3.49	-4.13
-49	0.46	0.39	-0.07	SUNTRUST BANKS	NA	NA	332.6	+1	1.22	1.16	-0.06
NM	-0.10	-2.81	-2.71	SUPERVALU ††	4,610.3	-15	59.0	+24	0.40	0.44	+0.04
NM	0.75	0.84	+0.09	SYSCO ††	5,591.0	+6	158.5	+14	0.23	0.24	+0.01
+12	1.21	1.21	—	TENET HEALTHCARE ††	3,394.0	+16	192.0	+10	0.69	0.57	-0.12
+10	0.39	0.39	—	U.S. BANCORP	NA	NA	695.4	-10	0.40	0.36	-0.04
-35	0.64	0.41	-0.23	US AIRWAYS GROUP	1,565.0	-34	-1,008.0	NM	-7.28	-14.89	-7.61
+187	0.49	0.60	+0.11	WALGREEN †	6,559.4	+17	185.9	+17	0.18	0.18	—
+26	0.37	0.39	+0.02	WASHINGTON MUTUAL	NA	NA	535.0	-29	0.94	0.62	-0.32
NM	0.01	-1.19	-1.20	WELLS FARGO	NA	NA	1,181.0	+5	0.69	0.69	—
+18	0.39	0.36	-0.03	TECHNOLOGY	72,029.2	-17	3,579.9	-54	0.20	0.11	-0.09
+17	1.06	1.27	+0.21	ADVANCED MICRO DEVICES	1,951.9	-19	-15.8	NM	-0.27	-0.05	+0.22
+21	1.82	2.03	+0.21	APPLE COMPUTER †	1,375.0	+37	38.0	NM	0.11	0.11	—
+5	0.81	0.81	—	AVAYA †	1,306.0	-27	-20.0	NM	0.07	-0.09	-0.16
-5	0.98	0.96	-0.02	COMPAQ COMPUTER	8,456.0	-26	92.0	NM	-0.03	0.05	+0.08
+8	0.45	0.48	+0.03	COMPUTER ASSOCIATES INTL. †††	749.0	-4	-231.0	NM	0.61	-0.40	-1.01
+61	0.33	0.25	-0.08	EBAY	219.4	+64	25.9	+9	0.12	0.09	-0.03
+39	0.34	0.30	-0.04	GENENTECH	569.4	+23	42.1	+195	0.19	0.00	-0.11
-34	0.45	0.49	+0.04	HUGHES ELECTRONICS	2,280.6	+11	-132.6	NM	-0.12	-0.12	—
-57	0.62	0.05	-0.57	IBM	22,826.0	-11	2,333.0	-13	1.32	1.33	+0.01
+45	0.72	0.73	+0.01	INTEL	6,983.0	-20	504.0	-77	0.09	0.07	-0.02
+19	0.67	0.69	+0.02	JABIL CIRCUIT †	884.6	-22	8.4	-82	0.12	0.04	-0.08
NM	-0.07	-0.11	-0.04	MICROSOFT ††	7,741.0	+18	2,283.0	-13	0.49	0.41	-0.08
NM	0.15	-0.07	-0.22	MOTOROLA	7,324.0	-27	-1,237.0	NM	-0.04	-0.55	-0.51
-37	0.43	0.41	-0.02	ORACLE ††	2,357.3	-11	549.5	-12	0.10	0.10	—
-32	0.55	0.36	-0.19	SOLETRON †	3,152.2	-45	-50.5	NM	0.05	-0.08	-0.13
NM	-0.07	0.01	+0.08	SUN MICROSYSTEMS ††	3,108.0	-39	-431.0	NM	-0.03	-0.13	-0.10
NM	-4.41	-5.17	-0.76	UNISYS	1,556.9	-19	-169.4	NM	0.13	-0.53	-0.66
+49	1.24	1.28	+0.04	YAHOO	188.9	-39	-8.7	NM	0.01	-0.02	-0.03
+21	0.89	1.08	+0.19	UTILITIES & TELECOM	49,466.8	-8	944.5	+419	0.20	0.12	-0.08
+40	0.34	0.37	+0.03	AMERICAN ELECTRIC POWER	14,200.0	+30	51.9	NM	0.57	0.16	-0.41
+31	0.55	0.46	-0.09	BELLSOUTH	6,213.0	+1	792.0	-29	0.60	0.42	-0.18
+7	0.80	0.80	—	CONSOLIDATED EDISON	1,942.6	-14	128.5	+160	0.56	0.59	+0.03
+23	0.63	0.62	-0.01	DUKE ENERGY	10,714.0	-30	225.0	-21	0.48	0.29	-0.19
-40	0.18	0.20	+0.02	DYNEGY	8,743.0	-13	77.0	-27	0.41	0.21	-0.20
NM	0.03	0.10	+0.07	FPL GROUP	1,839.0	-1	122.0	+74	0.68	0.70	+0.02
+36	0.75	0.74	-0.01	LUCENT TECHNOLOGIES †	3,579.0	-18	-423.0	NM	-0.18	-0.14	+0.04
0	0.28	0.28	—	NORTHEAST UTILITIES	1,766.2	+18	51.4	-8	0.39	0.38	-0.01
+89	1.23	1.27	+0.04	TELLABS	470.0	-59	-80.3	NM	0.02	-0.20	-0.22
+20	0.57	0.31	-0.26								
+23	0.28	0.30	+0.02								
+26	0.55	0.81	+0.26								
-17	0.88	0.93	+0.05								

† First-quarter results

†† Second-quarter results

††† Third-quarter results

NM = not meaningful

NA = not available

Data: Standard & Poor's COMPUSTAT

Earnings Estimate Data: Thomson Financial/First Call

† First-quarter results

†† Second-quarter results

††† Third-quarter results

NM = not meaningful

NA = not available

Data: Standard & Poor's COMPUSTAT
Earnings Estimate Data: Thomson Financial/First Call

pharmaceutical producers, for instance, cautioning their 2002 numbers will hurt by the loss of patents on blockbuster drugs.

Most companies' bottom lines are already looking awful. Charles L. Hill, research director at Thomson Financial/First Call, reckons that fourth-quarter earnings cratered 22.1% from year earlier. That's even worse than third quarter's 21.7% drop and

places 2001 in the record books as the first year since 1982 when income fell every quarter.

Moreover, Hill predicts profits will decline again in the current quarter, by 8%. That would make this earnings recession the longest since 1969-70. Tyco International Ltd. has cautioned that revenues in its flagship electronics unit could plummet 20% or more in the current quarter. Boeing, meantime, is al-

ready warning that sales could skid 7% in 2002. IBM, which stunned investors with an 11% plunge in fourth-quarter revenue, sees no quick comeback, either. Notes John R. Joyce, IBM's chief financial officer: "The first half of this year, at minimum, doesn't appear to have a much different economic look to it."

No wonder so many companies feel like they're on the ropes. They are.

By Michael Arndt in Chicago

RUNNING FOR COVERAGE

Suddenly, policies to cover execs are growing scarce

Buck naked. That's how many executives and company board members facing multimillion-dollar shareholder lawsuits may feel in the post-Enron era. Fearing an explosion of litigation over alleged executive misdeeds, insurers are retreating from writing Directors & Officers (D&O) policies to cover execs against court costs and fines if they are named in suits ranging from sexual harassment to insider trading. Insurers were already jittery about the growing number of dot-bomb class actions. Now the Enron Corp. debacle is "making everyone in the business recognize the potential severity of D&O losses," says John Keogh, president and COO of National Union Fire Insurance Co., American International Group Inc.'s D&O unit.

Less than a dozen companies—including AIG, Chubb, and Great American—underwrote 98% of such insurance in the U.S. in 2001. Eight insurers, including Aegis, Lloyd's of London, and St. Paul may face claims from Enron directors or officials. Aegis, as lead insurer, could be looking at \$100 million alone. On Jan. 18, Enron asked the Manhattan bankruptcy judge to make its insurers advance cash to executives and directors for legal fees.

Even before Enron collapsed, all major D&O insurers in the U.S. were taking stock of the business. Lloyd's of London, the third-largest player behind AIG and Chubb Corp., has cut back its U.S. D&O operations since early 2001, competitors claim. A Lloyd's spokeswoman would only say: "We have become extremely selective [about whom to insure]."

Premiums were slated to increase by 25%

to 400% because of the jump in shareholder litigation after the Nasdaq crash, says Willis Group Holdings, a London insurance broker. And insurers were increasing deductibles. Now they're drastically scaling back the scope of policies.

Typically, companies take out D&O insurance for high-profile execs and board members. Costs vary by business size and industry. Premiums averaged \$242,000 a year for utilities in 2000, reports Tillinghast-Towers Perrin, an insurance-industry consultancy, but were just \$67,000 for health-services companies.

Now, just getting coverage will be hard. Companies that a few years ago could buy all the D&O insurance they needed from one insurer may have to visit 8 or 10 to get covered, says Mark Larsen, a consultant with Tillinghast-

Towers Perrin. Insurers are "being very stingy with their coverage. They're only giving a handful of policies out to their best clients."

Enron is a worst-case scenario for D&O insurers. The pension holders and investors who have filed suits against the company, its officials, and directors know they'll get little from Enron, which is bankrupt. Instead, plaintiffs' lawyers say, their clients hope to recoup some of their losses on the approximately \$350 million in coverage that Enron had purchased for its directors and execs—which the company had increased substantially after

1999. The insurers will surely fight claims in court, and it's far from certain that they'll lose. As a rule, D&O insurance doesn't cover instances of fraud or criminal wrongdoing.

Insurers deserve some of the blame for their rising D&O risk. After Congress passed the Private Securities Litigation Reform Act of 1995—which, among other things, gave executives legal safe harbor when good-faith objections didn't pan out—insurers thought securities litigation would all but evaporate. They rushed headlong into the D&O market, cutting premiums and offering bonuses such as longer contracts and extra coverage to companies that upgraded their policies. Total available D&O coverage sold annually to U.S. businesses rose 70% between 1995 and 2000 to \$1.5 billion.

Instead, after the Nasdaq crash in spring, 2000, shareholders went on a litigation rampage against tech companies and their investment banks. Securities class-action settlements more than doubled between 1995 and 2000, to \$1.5 billion. Average damage awards jumped from \$25 million per case to \$200 million in that period. Much of that money ultimately came from D&O coverage.

Now that Enron makes the market look even riskier, some companies find that they can't afford D&O insurance at all, says Fred Podolsky, CEO of executive risk practices at London-based Willis Group. If that happens, top executives will have more reason than ever to make sure that their company is covered. After all, their wallets will be on the line.

By Heather Timmons in New York

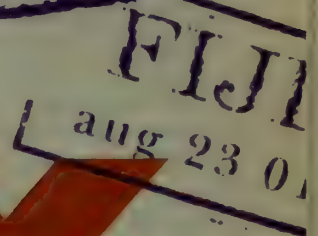


INSURING THE BOSS AFTER ENRON

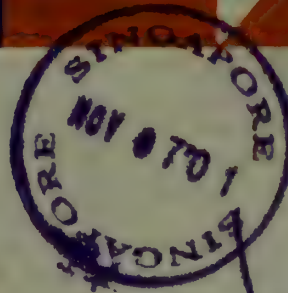
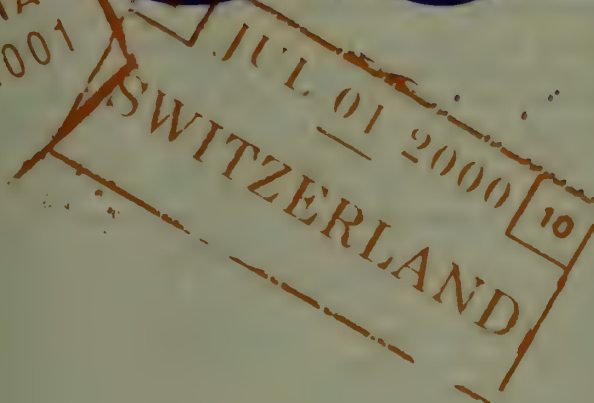
Why Directors & Officers insurance is harder to get and more expensive:

- Shareholder class actions have more than doubled in 2001 because of the bear market of 2000, and settlements are getting bigger
- Lloyd's of London has restricted underwriting in the U.S., Reliance Insurance filed for bankruptcy, and other major players are tightening standards
- The spread of aggressive accounting is making insurers much pickier about which companies they will underwrite

Data: Tillinghast-Towers Perrin



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COMMENTARY

By Dean Foust

THIS STOCK MAY HARM YOUR PORTFOLIO'S HEALTH

For years, critics have griped that the Tisch family runs Loews Corp., the publicly traded holding company it controls, as its fiefdom. They're hard to challenge. The Tisch family owns 30% of the stock and holds 5 of 13 board seats. They get nice perks. The company's 74-year-old co-chairman, Preston R. Tisch, has the use of a Manhattan apartment in a company-owned hotel—a benefit worth \$1.8 million over the past three years, according to the 2001 proxy. Meanwhile, the average 4.5% annual return of Loews shares over the past five years pales against the 10.7% return of the Standard & Poor's 500-stock index. The Council of Institutional Investors, a pension-fund trade group, has repeatedly singled Loews out for its underperformance. (Loews officials wouldn't comment.)

Now, the Wall Street hype machine says that the younger Tisches are paying outside investors new respect. The evidence: James S. Tisch, Loews's 49-year-old chief executive, plans to launch a tracking stock in the coming weeks for its Greensboro (N.C.)-based subsidiary Lorillard Tobacco Co. When he unveiled the plan last October, analysts hailed it as an unlocking of the hidden value of Lorillard, which generates roughly a quarter of Loews's revenues but more than 60% of profits, according to Prudential Securities Inc. At less than six times projected 2002 profits, Carolina Group, the new tracker, could rise 10% to 20%, bulls say.

But on closer look, the Lorillard offering looks less like a boon for Loews's shareholders than a way to milk a cash cow that's past its prime. As the offering document states, Loews plans to plow the \$800 million to \$1 billion it expects from Carolina into its other holdings, such as insur-



PACKING NEWPORTS: Investors get little say

ance, oil drilling, and watches.

So what are investors likely to get from the tracker? Not much. They'll own shares representing 17.8% of Lorillard, the nation's third-largest cigarette maker after Philip Morris Cos. and R.J. Reynolds Tobacco Holdings Inc. That entitles them to a 6.7% dividend, but the shares don't reflect any direct claim on Lorillard's assets, as a spin-off would. Those stay with Loews, as do the offering's proceeds and Lorillard's cash flow. Carolina Group investors won't have much voice either: Ten Carolina shares equal one Loews share. "It's a good deal for the Tisches—they raise \$1 billion and keep the cash flow—but would I want to invest in Carolina Group? No. It's heads they win, tails I lose," says Joseph W. Cornell, president of researcher Spin-off Advisors LLC.

Another problem: Despite a 6% rise in revenues in the first nine

months of 2001, to \$3.4 billion, Lorillard's profits declined 14.8%, to \$475 million due to litigation expenses eroding market share among its discount brands, the prospectus says. And Lorillard's flagship Newport brand faces aggressive competition.

What investors will get in spades is legal risk. Lorillard is named in 4,275 lawsuits claiming it, like other tobacco companies, hid the risks of smoking. A possible ticking bomb is the Engle class action in Florida. A jury hit the industry with a \$145 billion judgment. Lorillard's share is \$16.25 billion. Loews executives declined comment, citing Securities & Exchange Commission restrictions. But the prospectus says that if the

Engle judgment stands, it "could result in the loss of all or substantially all of the value of any outstanding shares of Carolina Group stock."

Many Wall Street analysts say the odds Lorillard will have to pay out in the Engle case, or any others, have shrunk since the industry settled with the states. Anti-tobacco activists disagree. "There's no evidence the litigation risk is receding," says Richard Daynard, a Northeastern University law professor who heads the Tobacco Products Liability Project, which provides research for suits against the industry. "They're basically buying themselves partner for litigation risk. As usual, Larry Tisch is a lot smarter than Wall Street analysts." Given the risks, those who see this as a great investment may have smoke in their eyes.

Foust covers the tobacco industry

BEHIND THE SMOKE...

Why Loews's planned tracking stock for its tobacco business could burn investors:

LITIGATION RISK

Smokers won a \$16.25 billion jury award from Loews in a Florida court. If it stands, Lorillard could be forced to declare bankruptcy.

POTENTIAL CONFLICTS

The Tisch family controls Loews and the tobacco business. But what's good for Loews may not be good for investors in the tracker. The stock sale proceeds go to the parent company.

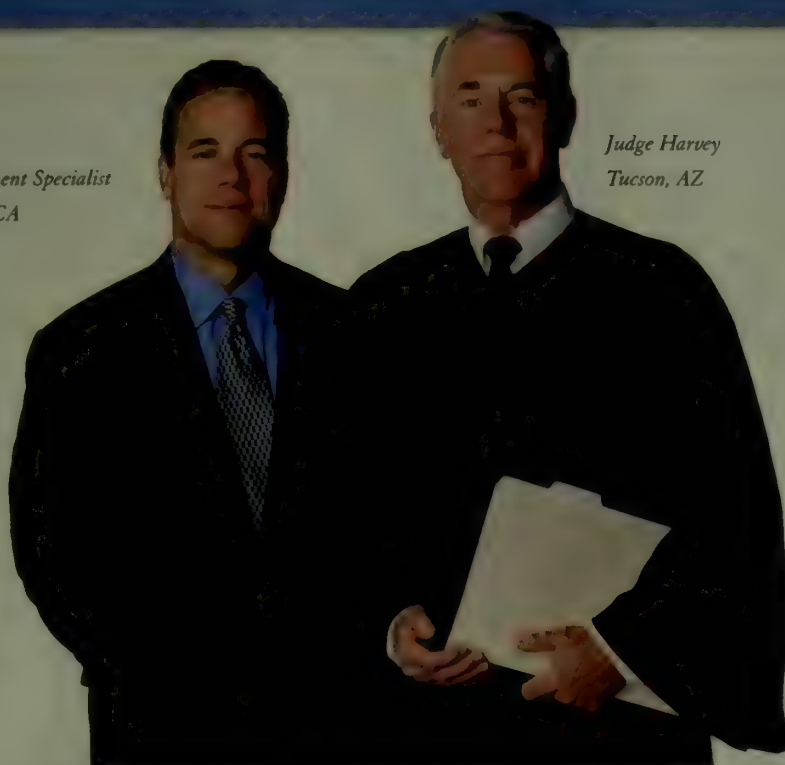
TRACKERS DON'T TRACK

Research shows that tracking stocks perform poorly over time because of their hard-to-understand structures, weak shareholder rights, and the risk of conflicts of interest with the parent.

Both pride themselves on being objective. But only one can recommend a mutual fund that fits in your portfolio.

David Morgan
Schwab Investment Specialist
Walnut Creek, CA

Judge Harvey
Tucson, AZ



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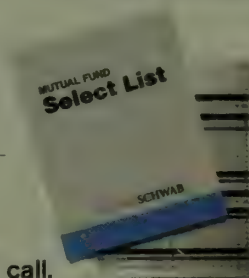
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INVESTING

THAT OLD BOND MAGIC MAY NOT LAST

Nevertheless, some bond funds still hold great potential. Here's our guide to the best

Bonds have beaten stocks hands down for two years running. Thank a lousy economy and a Federal Reserve Board on a tear to cut short-term interest rates. The average bond has soared 10% a year since 1999, while equities have tumbled by an equal amount, resulting in some of the best relative returns for bonds—from rock-solid U.S. Treasuries to emerging-market debt—in years.

Taxable bond funds flew off the shelf last year: An inflow of \$76.5 billion through November was their biggest ever, while net inflows into equity mutual funds were on track to be the smallest since 1990. But before you plunge any deeper, be aware that many pros consider an encore unlikely. "The powerful excess returns of bonds vs. stocks

is yesterday's news," says J. Thomas Madden, Federated Investors' chief investment officer in Pittsburgh, Pa.

Indeed, holders of longer-term U.S. Treasury bonds could get whipsawed. Even a modest recovery may prompt the Fed to go into reverse and tighten short-term rates by as much as 1.5 percentage points by yearend, says Paul Lefurgey, manager of \$4.8 billion in fixed-income products for Duff & Phelps Investment Management in Chicago. That will send bonds, which fall when interest rates rise, tumbling. If the yield on a 10-year Treasury jumps by half a percentage point from about 5% now, it will lose about 10% of its market value. "If you are loading up your portfolio with hyper-quality issues anticipating a need for being risk-averse, you're over-

doing it," warns Keith F. Karlawish, rector of fixed income for BB&T Asset Management.

Does that mean you should dump your bond holdings or forget about adding new ones? Heavens, no. Rather, it's time to temper expectations, vary the mix and seek higher yields. The key is finding funds that hold the greatest potential for long-term gains. The best opportunities, say the pros, lie in investment-grade corporate debt and the highest-quality junk debt, which pays 2.2 and 9.8 percentage points respectively above Treasuries with the same maturity. The premiums are likely to narrow sharply if the economy improves. Moreover, the percentage points of extra yield from emerging-market debt pays looks enticing, too. Bond guru William H. Gr

The Bond-Fund A-List

The 101 fixed-income funds that earned an A—our rating for superior risk-adjusted returns over the past five years

ID	AVERAGE ANNUAL TOTAL RETURN (%)**	INVESTMENT CATEGORY	FUND	AVERAGE ANNUAL TOTAL RETURN (%)**	INVESTMENT CATEGORY
WALL ST. TAX-FREE SHT.-INT. FIXED INC.**	3.9	Muni. Short	J. P. MORGAN SHORT-TERM BOND INSTL.	6.2	Intermediate (General)
LIMITED MATURITY TREASURY A	5.8	Short Government	NATIONS SHORT-TERM MUNI. INCOME INV. A**	4.3	Muni. Short
TAX-FREE INTERMEDIATE SHARES**	5.1	Muni. National Interm.	NUVEEN FLAGSHIP OHIO MUNI. BOND R**	6.7	Muni. Single State Long
ER. CENT. CALIF. LTD.-TERM TAX-FREE INV.**	4.7	Muni. Calif. Interm.	OFFITBANK N.Y. MUNICIPAL SELECT**	6.0	Muni. New York Interm.
ER. CENTURY FLA. MUNI. BOND INV.**	5.7	Muni. Single State Long	ONE GROUP SHORT-TERM BOND I	6.4	Short (General)
ER. CENTURY LTD.-TERM TAX-FREE INV.**	4.8	Muni. National Interm.	ONE GROUP ULTRA SHORT-TERM BOND A**	5.8	Ultrashort
ERICAN PERFORMANCE SHORT-TERM INC. **	7.0	Short (General)	OPPENHEIMER ROCHESTER LTD. N.Y. MUNI. A**	5.0	Muni. New York Interm.
INSTEIN SHORT DURATION CALIF. MUNI.**	3.8	Muni. Short	PAYDEN GLOBAL SHORT BOND R**	6.1	International Bond
INSTEIN SHORT DURATION DIV. MUNI.**	4.1	Muni. Short	PAYDEN LIMITED MATURITY R**	5.7	Short (General)
INSTEIN SHORT DURATION N.Y. MUNI.**	3.8	Muni. Short	PAYDEN SHORT BOND R**	6.4	Short (General)
VERT TAX-FREE RESERVE LTD.-TERM A**	4.0	Muni. Short	PAYDEN SHORT DURATION TAX-EXEMPT R**	4.2	Muni. Short
BRADDO BONDSHARES**	6.8	Muni. Single State Long	PERFORMANCE SHORT GOVT. INC. INSTL.**	6.1	Short Government
YFUS BASIC INTERM. MUNI. BOND**	5.9	Muni. National Interm.	PERMANENT VERSATILE BOND**	5.2	Short (General)
YFUS SHORT-INTERM. MUNI. BOND**	4.3	Muni. Short	T. ROWE PRICE MD. SHORT-TERM TAX-FREE**	4.3	Muni. Single State Interm.
REE KY. TAX-FREE SHORT TO MED.**	4.2	Muni. Single State Interm.	T. ROWE PRICE SHORT-TERM BOND	6.3	Short (General)
REE N.C. TAX-FREE SHORT TO MED.**	4.3	Muni. Single State Interm.	T. ROWE PRICE SUMMIT MUNI. INTERM.**	5.4	Muni. National Interm.
REE TENN. TAX-FREE SHORT TO MED.**	4.1	Muni. Single State Interm.	T. ROWE PRICE TAX-FREE SHORT-INTERM.**	4.8	Muni. National Interm.
IPSE SHORT-TERM BOND**	6.2	Short (General)	RSI RETIREMENT SHORT-TERM INVESTMENT	4.9	Short Government
IPSE ULTRA SHORT-TERM INCOME**	5.9	Ultrashort	FRANK RUSSELL SHORT-TERM BOND S**	6.2	Short (General)
ROGREEN SHORT-INTERM. MUNI. A**	4.1	Muni. National Interm.	SEI DAILY SHORT DURATION GOVT. A**	6.2	Intermediate Government
ELSIOR SHORT-TERM GOVT. SEC.**	5.9	Short Government	SMBR CAPITAL PRIMARY T**	4.8	Ultrashort
ELSIOR SHORT-TERM TAX EXEMPT SEC.**	4.1	Muni. Short	SSGA YIELD PLUS**	5.4	Ultrashort
ERATED ARMS INSTITUTIONAL**	5.6	Ultrashort	SCHWAB CALIF. SHT.-INTERM. TAX-FREE BOND**	4.5	Muni. Calif. Interm.
ERATED LIMITED DURATION GOVT. IS**	5.6	Ultrashort	SCHWAB SHORT-INTERM. TAX-FREE BOND**	4.3	Muni. National Interm.
ERATED LIMITED DURATION INSTL.**	6.5	Short (General)	SIT MINN. TAX-FREE INCOME**	4.8	Muni. Single State Long
ERATED LIMITED TERM MUNI. A**	4.0	Muni. Short	SIT U.S. GOVERNMENT SECURITIES**	6.7	Short Government
ERATED SHORT-TERM INCOME INSTL.**	6.3	Short (General)	STANDISH CONTROLLED MATURITY**	6.3	Short (General)
ERATED SHORT-TERM MUNI. TO. INSTL.**	4.3	Muni. Short	STANDISH INTERMEDIATE TAX-EXEMPT BOND**	5.1	Muni. National Interm.
ERATED U.S. GOVT. SEC. 1-3 YRS. INSTL.**	5.9	Short Government	STANDISH SHORT-TERM ASSET RESERVE**	5.9	Short (General)
ELITY SHORT-TERM BOND	6.2	Short (General)	STRONG ADVANTAGE INVESTMENT	5.5	Ultrashort
ELITY SPARTAN INTERM. MUNI. INC.**	5.5	Muni. National Interm.	STRONG ADVISOR BOND INSTITUTIONAL**	9.4	Intermediate (General)
ELITY SPARTAN SHORT INTERM. MUNI. INC.**	4.7	Muni. National Interm.	STRONG MUNICIPAL ADVANTAGE INVESTMENT**	3.9	Muni. Short
IN THIRD MICH. MUNICIPAL BOND INV.**	4.3	Muni. Single State Interm.	STRONG SHORT-TERM MUNICIPAL BOND INV.**	4.8	Muni. Short
ST AMERICAN SHORT-TERM BOND A**	6.1	Short (General)	TCW GALILEO MORTGAGE-BACKED SEC. I**	6.0	Short Government
ST TENN. TAX-FREE I**	5.4	Muni. Single State Interm.	THORNBURG FLA. INTERMEDIATE MUNI. A**	4.9	Muni. Single State Interm.
INKLIN INV. SEC. ADJ. U.S. GOVT. SEC.**	5.7	Ultrashort	THORNBURG LIMITED-TERM MUNI. CALIF. A**	4.3	Muni. Calif. Interm.
AXY SHORT-TERM BOND TRUST**	6.0	Short (General)	THORNBURG LIMITED-TERM MUNI. NATL. A**	4.4	Muni. National Interm.
WMEDE MUNI. INTERMEDIATE**	5.1	Muni. National Interm.	THORNBURG N.M. INTERMEDIATE MUNI. A**	4.5	Muni. Single State Interm.
WMEDE N.J. MUNI.**	5.1	Muni. Single State Interm.	U.S. GLOBAL INV. NEAR-TERM TAX-FREE**	4.5	Muni. National Interm.
OMAN SACHS ADJ. RATE GOVT. A**	5.4	Ultrashort	USAA TAX-EXEMPT INTERMEDIATE TERM**	5.6	Muni. National Interm.
RON SHORT DURATION**	6.0	Intermediate (General)	USAA TAX-EXEMPT SHORT-TERM**	4.7	Muni. Short
YAHN INTERMEDIATE**	4.2	Muni. Single State Interm.	VANGUARD CALIF. INS. INTERM.-TERM TE**	5.6	Muni. Calif. Interm.
NESTEAD SHORT-TERM BOND**	6.2	Short (General)	VANGUARD MUNI BOND LIMITED TERM**	4.7	Muni. National Interm.
NESTEAD SHORT-TERM GOVT. SEC.**	5.5	Short Government	VANGUARD SHORT-TERM BOND INDEX	6.9	Short (General)
IGN FLA. TAX-FREE SHORT-TERM**	4.3	Muni. Short	VANGUARD SHORT-TERM CORP.	6.6	Short (General)
US SHORT-TERM BOND	6.2	Short (General)	VANGUARD SHORT-TERM FEDERAL	6.7	Short Government
INSTITUTIONAL LIMITED DURATION	6.4	Short (General)	VANGUARD SHORT-TERM TAX-EXEMPT**	4.1	Muni. Short
LIMITED DURATION**	6.2	Short (General)	WELLS FARGO NAT. LTD.-TERM TAX-FREE I**	4.8	Muni. National Interm.
CURY LOW DURATION I**	6.2	Short (General)	WELLS FARGO STABLE INCOME I**	5.7	Short (General)
BRILL LYNCH MUNI. BOND LTD. MAT. B**	3.8	Muni. Short			
TEREY PIA SHORT-TERM GOVT.**	6.3	Intermediate Government			
MONTGOMERY SHORT DUR. GOVT. BOND R**	6.5	Short Government			

*1997-2001, appreciation plus reinvestment of dividends and capital gains before taxes
 **More fund data on BusinessWeek Online

Data: Standard & Poor's

Mutual Fund Scoreboard

manager of PIMCO Total Return, says there's plenty of money to be made. He's been buying corporate bonds, mortgage securities, and emerging-market debt, figuring he can get an 8% total return on his money. "With 1.5% inflation and a 5% stock market world," he says. "They look quite sexy."

However, with most of the easy money already wrung out of the bond market, it's going to take nifty footwork to beat the averages. Where to start? Here, with the 17th edition of the *BusinessWeek* Mutual Fund Scoreboard, prepared by Standard & Poor's, which is also owned by The McGraw-Hill Companies.

The crème-de-la-crème of bond funds get our A rating by producing the highest returns for the least risk over the past five years. It's an exclusive bunch: Only 101 out of 1,656 funds meet the criteria this year (page 83). We've also rated funds against their peers in each category (page 85). Starting on page 86, you'll find the Scoreboard, with 190 taxable funds and 143 tax-exempt funds. Our Web site at www.businessweek.com/mutualfunds/ gives those and 1,323 more funds in an interactive Scoreboard version. There you'll find tools to screen funds by sales charges and expenses, average maturity, or fund size. The Scoreboard covers the whole gamut of funds. At one extreme are the emerging-market bond funds—a group boasting the best three-year and 2001 returns. As the global economy improves, stable emerging markets with ties to major industrialized nations, such as Mexico and Poland, will rebound first (page 97). Yet these funds are not for the faint of heart: None rates higher than B+ because of the sector's erratic year-to-year returns.

Some of the biggest bang for the buck has come from corporate bond funds over the past five years. That trend, once the economy picks up, is expected to continue. It's not going to move in a straight line, however. Remember, the consensus wrongly assumed at this time last year that the economy would respond to the Fed's aggressive easing in 2000. So investors should "tip-toe in rather than dive head-first," says Colin J. Lundgren,

How the Groups Fared

Emerging markets and corporate bonds led the way

CATEGORY	AVERAGE ANNUAL TOTAL RETURN (%)*		
	2001	1991-2001	1997-2001
EMERGING MARKETS BOND	11.0	16.3	5.2
LONG (GENERAL)	7.9	5.1	6.5
INTERMEDIATE (GENERAL)	7.6	5.4	6.4
SHORT (GENERAL)	7.4	6.0	6.0
INTERMEDIATE GOVERNMENT	7.1	5.6	6.5
SHORT GOVERNMENT	6.8	5.6	5.8
ULTRASHORT	5.3	5.2	5.3
LONG GOVERNMENT	5.2	4.7	6.7
MUNI. NATIONAL INTERM.	4.8	4.0	4.9
MUNI. SHORT	4.8	3.9	4.1
MUNI. HIGH YIELD	4.7	1.7	4.0
MUNI. SINGLE-STATE INTERM.	4.5	3.7	4.7
MUNI. SINGLE-STATE LONG	4.4	3.6	5.0
MUNI. NATIONAL LONG	4.1	3.5	5.0
MULTISECTOR	3.7	2.2	3.0
INTERNATIONAL BOND	2.1	1.4	2.9
HIGH YIELD	1.8	-0.6	1.9
CONVERTIBLES	-7.0	7.3	8.7
ALL TAXABLES	5.5	4.5	5.7
ALL TAX FREE	4.3	3.6	5.0
ALL BOND	5.0	4.1	5.3

*Appreciation plus reinvestment of dividends and capital gains before taxes

Data: Standard & Poor's

senior fixed-income manager of \$7 billion in bond funds at American Express Asset Management Group Inc.

Bond-fund managers themselves are leaning toward A-rated corporate bonds, which still qualify as investment grade, albeit at a low level. And there's a fresh supply of corporate bonds on the market. Companies such as DaimlerChrysler

and Duke Energy Corp. have issued new debt to lure investors looking for alternatives to yielding government bonds. Now managers are now sniffing around for debt from cyclical companies, says Duff & Phelps's Lefurgey, including auto companies, industrial outfits, and retailers that should benefit first from an economic swing. Some of the best specialists in the sector include Fidelity Intermediate Bond, MFS Limited Duration, and Wachovia Short-Term Fixed-Income funds. The American Fidelity fund, for example, gained 8.4% last year by feasting on over-rated corporate bonds—even in an iffy climate. The fund ranked in the top of the five- and 10-performance charts.

With Corporate America struggling, some investors may be leery about defaults. But while defaults are nearing record levels, they appear to be headed for a plateau. The number of corporate issuers defaulting last year soared to 211, representing \$115.4 billion of debt, up from 132 issuers and \$42.3 billion in 2000, according to S&P. Those defaults, a lagging indicator of economic health, are expected to climb until summer, then "improve gradually," says Diane Vazza, S&P's head of global fixed-income research. "We're bottoming in this quarter." Furthermore, the extra 10 percentage points of yield on junk bonds compared to Treasuries is historically high and stable where it was a couple of years

"The best investments may now be at their darkest hour," says Vazza.

Picking an A-rated junk bond fund from *BusinessWeek*'s list increases your chances that you'll get a steady-as-she-goes manager, not one who overdoses on the pursuit of high returns. You won't find managers who go heavily and recklessly into telecom companies: The telecom slice of the Merrill Lynch High Yield Master Index guide to overall junk-bond performance, had the worst results last year, down 3%. And prospects—indicated by the 30% yields that many are paying now—aren't too bright either. "There's a lot of opportunity, [but] if you don't know what you're doing, it's very risky," says Amy F.

The Largest Funds

Here's how *BusinessWeek* rates the largest bond funds

FUND	ASSETS MILLIONS	AVG. ANNUAL 5-YR. RETURN (%)*	OVERALL RATING
VANGUARD GNMA	\$15.7	7.2	B+
VANGUARD TOTAL BOND MARKET INDEX	14.3	7.3	B
FRANKLIN CALIF. TAX-FREE INC. A	13.4	5.6	C
BOND FUND OF AMERICA A	11.3	6.0	C-
VANGUARD SHORT-TERM CORPORATE	7.4	6.6	A
FRANKLIN GOVERNMENT SECURITIES A	7.2	7.0	B+
VANGUARD INTERMED. TERM TAX EXEMPT	6.7	5.3	B+
FRANKLIN FEDERAL TAX-FREE INC. A	6.7	5.3	B
VANGUARD HIGH-YIELD CORPORATE	5.3	4.3	C-
FIDELITY INTERMEDIATE BOND	4.8	6.8	B+
FRANKLIN HIGH-YIELD TAX-FREE INC. A	4.7	4.7	C
AXP HIGH-YIELD TAX EXEMPT A	4.6	5.0	C
FIDELITY SPARTAN MUNI. INC.	4.6	5.8	B+
FRANKLIN N.Y. TAX FREE INC. A	4.6	5.7	B+
OPPENHEIMER ROCHESTER MUNICIPAL A	4.1	5.5	C

*1997-2001, appreciation plus reinvestment of dividends and capital gains before taxes

Data: Standard & Poor's

The Best of Class

ating bond funds against their peers, we awarded A's to these funds:

	TOTAL RETURN*	FUND	TOTAL RETURN*
CONVERTIBLES			
IMOS MARKET NEUTRAL A**	11.3%		
HIGH-YIELD			
IMBIA HIGH-YIELD**	6.3		
TRUST SRS. HIGH-YIELD BOND A**	5.3		
ER HIGH INCOME BOND RETAIL**	7.3		
IMAN INV. TR. FLEXIBLE BOND**	2.6		
INTERMEDIATE (GENERAL)			
ANAN PERFORMANCE INTERM. BOND**	6.7		
KROCK LOW DURATION INV. A**	6.1		
FWS INTERMEDIATE TERM INC.**	9.2		
LITY INTERMEDIATE BOND	6.8		
T AMERICAN INTERM. TERM BOND Y	6.8		
OR SHORT DURATION	6.0		
LIMITED MATURITY A**	5.8		
MORGAN SHORT-TERM BOND INSTL.	6.2		
ING ADVISOR BOND INSTL.**	9.4		
NOVIA SHORT-TERM FIXED INC. A**	6.1		
IZ FIXED INCOME**	6.8		
INTERMEDIATE GOVERNMENT			
ESSOR MORTGAGE SECURITIES ADV.**	7.2		
IGAN CENTURY GNMA INV.	6.8		
RATED INCOME TRUST INSTL.	7.0		
LITY MORTGAGE SECURITIES INITIAL	7.1		
KLIN STRATEGIC MORTGAGE**	7.6		
GOVERNMENT LIMITED MATURITY A**	5.9		
TEREY PIA SHORT-TERM GOVT.**	6.3		
DAILY SHORT DURATION GOVT. A**	6.2		
GUARD GNMA	7.2		
INTERNATIONAL BOND			
ILL LYNCH SHORT-TERM GLOBAL INC. B**	4.2		
EN GLOBAL FIXED INCOME R**	7.7		
EN GLOBAL SHORT BOND R**	6.1		
LONG (GENERAL)			
ERT INCOME A	9.6		
SE & COX INCOME	7.6		
WESTERN AST. GOME PORTFOLIO INSTL.	7.8		
FIXED INCOME INSTITUTIONAL	7.3		
LONG GOVERNMENT			
ADA U.S. GOVT. INCOME I**	6.8		
WARE LIMITED-TERM GOVT. A**	6.0		
CO GNMA**	6.5		
MULTISECTOR			
IS FLEXIBLE INCOME**	6.5		
EWENBEN PAGE STRAT. FIXED-INC. P**	6.9		
MUNICIPAL CALIF. INTERM.			
IGH CENT. CALIF. LTD.-TERM TAX-FREE INV.**	4.7		
MUNICIPAL CALIF. LONG			
IGAN CENTURY CALIF. HIGH-YIELD MUNI.**	6.1		
LITY SPARTAN CALIF. MUNI. INC.	6.0		
MORGAN CALIF. BOND INSTL.**	5.4		
MUNICIPAL HIGH-YIELD			
ODER HIGH-YIELD TAX-FREE S	6.0		
MUNICIPAL NATIONAL INTERM.			
FIDELITY SPARTAN SHORT-INTERM. MUNI. INC.	4.7		
GLENMEDE MUNI. INTERMEDIATE**	5.1		
T. ROWE PRICE TAX-FREE SHORT INTERM.	4.8		
VANGUARD MUNI. BOND LIMITED-TERM	4.7		
MUNICIPAL NATIONAL LONG			
AMERICAN CENTURY TAX-FREE BOND INV.**	5.1		
DELAWARE TAX-FREE USA INTERM. A**	5.0		
HARRIS INSIGHT INTERM. TAX EXMPT. BOND M**	5.0		
M.S. MUNICIPAL INSTITUTIONAL**	6.1		
NUVEEN INT. DUR. MUNICIPAL BOND R	5.5		
FRANK RUSSELL TAX EXEMPT BOND S**	4.3		
SALOMON BROTHERS NATL. TAX-FREE INC. A**	6.4		
SIT TAX-FREE INCOME	5.1		
MUNICIPAL NEW YORK LONG			
FRANKLIN N.Y. TAX-FREE INC. A	5.7		
NUVEEN N.Y. MUNICIPAL BOND R**	5.7		
USAA TAX EXEMPT NEW YORK BOND**	6.1		
MUNICIPAL SHORT			
USAA TAX EXEMPT SHORT-TERM	4.7		
MUNICIPAL SINGLE-STATE INTERM.			
DUPREE N.C. TAX-FREE SHORT TO MED.**	4.3		
DUPREE TENN. TAX-FREE SHORT TO MED.**	4.1		
FIFTH THIRD MICH. MUNICIPAL BOND INV.**	4.3		
GLENMEDE N.J. MUNICIPAL**	5.1		
T. ROWE PRICE MD. SHT.-TERM TAX-FREE BOND**	4.3		
MUNICIPAL SINGLE-STATE LONG			
ALLIANCE MUNI. INCOME ARIZ. A**	6.2		
ALLIANCE MUNI. INCOME MICH. A**	6.5		
AMERICA CENTURY FLA. MUNI. BOND INV.**	5.7		
COLORADO BONDSHARES**	6.8		
FIDELITY SPARTAN ARIZ. MUNI. INC.**	5.4		
FIDELITY SPARTAN CONN. MUNI. INC.	5.7		
FIDELITY SPARTAN FLA. MUNI. INC.	5.6		
FIDELITY SPARTAN MASS. MUNI. INC.	5.7		
FIDELITY SPARTAN MD. MUNI. INC.**	5.6		
FIDELITY SPARTAN MINN. MUNI. INC.	5.3		
FIDELITY SPARTAN N.J. MUNI. INC.	5.6		
FIDELITY SPARTAN PA. MUNI. INC.**	5.5		
HAWAII MUNICIPAL**	4.5		
NUVEEN FLAGSHIP OHIO MUNI. BOND R**	6.7		
NUVEEN MASS. MUNICIPAL BOND R**	5.0		
OCEAN STATE TAX-EXEMPT**	4.6		
T. ROWE PRICE MD. TAX-FREE BOND	5.5		
RANSON MANAGED KAN. MUNICIPAL**	4.6		
RUSHMORE FUND FOR TAX-FREE INVEST. MD.**	5.0		
SIT MINN. TAX-FREE INCOME**	4.8		
VANGUARD N.J. INS. LONG TAX-EXEMPT	5.8		
VANGUARD PA. INS. LONG TAX-EXEMPT	5.7		
SHORT (GENERAL)			
AMERICAN PERFORMANCE SHORT-TERM INC.**	7.0		
PAYDEN LIMITED MATURITY R**	5.7		
STANDISH SHORT-TERM ASSET RESERVE**	5.9		
SHORT (GOVERNMENT)			
RSI RETIREMENT SHORT-TERM INVESTMENT**	4.9		
TCW GALILEO MORTGAGE-BACKED SEC. I**	6.0		
ULTRASHORT			
SSGA YIELD PLUS**	5.4		

1997-2001, appreciation plus reinvestment of dividends and capital gains before taxes
 ore fund data on BusinessWeek Online

Data: Standard & Poor's

Global Fixed-Income Strategist for Morgan Stanley. Funds such as the Merrill Lynch Bond High Income, Invesco High Yield and AIM High Yield funds get flunking grades in the Scoreboard, mostly for overweighting telecoms.

There are, however, high-yield fund managers who have deftly sidestepped the blowups. Consider the A-rated Columbia High-Yield Fund. The fund maintains an average credit rating of BB—just one level below investment grade. Managers Jeffrey L. Rippey and Kurt M. Havnaer have profited from defensive health-care companies, up 17% last year. Their winners included bonds issued by Tenet Healthcare Corp. and Health Care Property Investors Inc., a real estate investment trust. They figure that the market is purging itself of poor-credit qualities, which bodes well for high-yield companies that they invest in. Rippey and Havnaer are even tempted these days to venture into slightly riskier terrain: B-rated American Axle & Manufacturing Holdings Inc. and Iron Mountain Inc. "We've sold some of our most defensive names," says Havnaer. "But we're still buying companies that are getting upgraded in credit quality."

Even short-duration bond funds are taking on additional risk. Sandy R. Rufenacht, portfolio manager for the A-rated Janus Short-Term Bond Fund, is turbocharging his blue-chip offering with some lower-rated paper. At first blush, you'll see that Rufenacht favors top-shelf debt from General Electric, IBM, and Wal-Mart Stores. "I don't get too fancy, and I try to pay a lot of attention to what the economy is doing," he says. Rufenacht locks in his yields with debt that has a three-year duration, which in a declining interest-rate environment makes good sense. But Rufenacht—who also doubles as Janus' High-Yield Fund manager—juices the returns on his short fund with high-yield debt that's on the verge of being repaid. Currently 0.45% of the portfolio is in two-year, BB-rated bonds issued by Apple Computer Inc., yielding 6.5%. Another tiny position is in Tritel Communications Inc., a wireless cell-phone provider that will pay a 10.4% coupon, until its new acquirer, AT&T, buys back the bonds.

Mutual funds that invest in bonds aren't likely to be the show-stopper they've been recently. But at least, with the help of this Scoreboard issue, you're less likely to buy a flop.

By Mara Der Hovanesian
 in New York

BusinessWeek online

For info on 1,300 additional
 bond funds, go to
www.businessweek.com/mutualfunds/

Bond Funds

MUTUAL FUND SCOREBOARD

How to Use the Tables

BUSINESS WEEK RATING

Ratings measure risk-adjusted performance. This shows how well a fund performed relative to other funds and relative to the level of risk it took. Risk-adjusted performance is determined by subtracting a fund's risk-of-loss factor (see below) from its historic total return. Performance calculations are based on the five-year time period between Jan. 1, 1997, and Dec. 31, 2001. For BW ratings, funds are divided into taxable and tax-exempt funds. Funds are also rated against others in their category. Ratings are based on a normal statistical distribution within each group and awarded as follows:

A	SUPERIOR
B+	VERY GOOD
B	ABOVE AVERAGE
C	AVERAGE
C-	BELOW AVERAGE
D	POOR
F	VERY POOR

RISK

The risk-of-loss factor is the potential for losing money in a fund, calculated as follows: The monthly Treasury bill return is subtracted from the fund's total return for each of the 60 months in the rating period. When a fund has underperformed Treasury bills, the result is negative. The sum of these negative numbers is then divided by the number of months in the period. The result is a negative number, and the greater its magnitude, the higher the risk of loss.

PERFORMANCE COMPARISON

The tables provide performance data over three time periods. Here are equivalent total returns for the Lehman Brothers bond indexes during those periods:

	AGGREGATE	MUNI.
2001	8.4%	5.1%
3-year average (1999-2001)	6.3%	4.8%
5-year average (1997-2001)	7.4%	6.0%

FUND CATEGORIES

General bond funds are classified long-term (CL), intermediate-term (CI), short-term (CS), and ultra-short (UB); government, long (GL), intermediate (GI), and short (GS);

municipal, national long (ML), national intermediate (MI), single-state long (SL), "single-state intermediate (SI), Calif. long (MC), Calif. intermediate (MF), New York long (MY), New York intermediate (MN), short-term (MS) and high-yield (MH); specialized funds, convertible (CV), high-yield (HY), international (IB), emerging markets (EB), and multisector (MU).

SALES CHARGE

The cost of buying a fund, commonly called the 'load.' Many funds take loads out of initial investments, and for ratings purposes, performance is reduced by these charges. Loads on withdrawals can take two forms. Deferred charges decrease over time. Redemption fees are imposed whenever investors sell shares. Funds with none of these charges are called 'no-load.'

EXPENSE RATIO

Fund expenses for 2001 as a percentage of average net assets. The measures show how much shareholders pay for fund management. Footnotes indicate 12(b)-1 plans, which allocate shareholder money for marketing

costs. The average expense is 0.99% for taxable funds 0.89% for tax-free funds.

TOTAL RETURN

A fund's net gain to investors including reinvestment of dividends and capital gains at month-end prices.

YIELD

Income distributions during 2001 expressed as a percentage of net asset value, adjusted for capital gains.

MATURITY

The average maturity of the securities in a fund's portfolio, weighted by market value.

HISTORY

A fund's relative performance during the five 12-month periods from Jan. 1, 1997, to Dec. 31, 2001. The numbers designate which quintile the fund was in during the period: **1** for the top quintile; **2** for the second quintile; **3** for the third quintile; **4** for the fourth quintile and **5** for the bottom quintile. No number indicates no data for that period.

TELEPHONE NUMBERS

See index on page 93.

FUND	RATING	CATEGORY	RATING	SIZE	% CHG.	FEES	PERFORMANCE	PORTFOLIO	HIST.
(COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)		(RATING COMPARES FUND WITHIN CATEGORY)		ASSETS \$MIL.	2000-2001	SALES CHARGE (%)	EXPENSE RATIO (%)	TOTAL RETURN (%) 1 YR. 3 YR. 5 YR.	YIELD (%) MATURITY (YEARS) RESULTS ALL F.
TAXABLE									
AIM HIGH YIELD B	F	HY	F	716.6	-16	0.00**	1.75†	-4.3 -9.8 -5.1	13.2 5.8 152
AIM LTD. MAT. TREASURY A	A	GS	B	607.5	96	1.00	0.56†	7.5 5.7 5.8	4.3 1.5 531
ALLIANCE CORPORATE BOND A	C-	CL	F	554.7	16	4.25**	1.31†	8.3 6.1 5.9	7.7 26.0 151
ALLIANCE N. AMER. GOVT. INC. A	C-	IB	C	1004.6	4	4.25**	1.33†	0.2 8.6 9.4	10.2 13.3 121
ALLIANCE U.S. GOVT. PORT. A	C-	GI	F	899.0	100	4.25**	2.11†	5.7 4.9 6.3	6.3 19.7 314
AMER. CENTURY GINNIE MAE INV. (a)	B+	GI	A	1665.0	30	No load	0.59	7.4 8.2 8.8	6.0 21.2 322
AMER. CENTURY SHORT TERM GOVT. INV.	B+	GS	C	816.2	7	No load	0.59	7.1 5.6 5.7	5.1 4.9 531
AMERICAN HIGH INCOME TR. A	D	HY	B	3301.1	27	3.75**	0.83†	7.4 3.7 4.9	9.8 8.6 151
ARMADA BOND I	C	CL	B	814.0	-9	No load	0.72	7.4 5.7 6.8	6.1 NA 213
AXP BOND A	C	CL	C	2439.4	13	4.75	0.94†	7.3 4.6 5.9	5.7 14.7 142
AXP EXTRA INCOME A	D	HY	C	1780.8	-4	4.75	1.04†	4.7 0.2 1.5	11.1 5.8 151
AXP FEDERAL INCOME A	B	GL	B	1216.9	21	4.75	0.98†	8.8 4.6 5.7	4.5 10.0 422
AXP SELECTIVE A	C	CL	B	1097.2	16	4.75	0.97†	6.9 5.2 5.4	4.8 16.7 313
BERNSTEIN INTERM. DURATION	B	CI	C	2171.5	8	No load	0.61	7.3 5.4 6.1	5.1 NA 422
BOND FUND OF AMERICA A	C-	CI	D	11334.2	24	3.75**	0.72†	7.2 5.2 6.0	6.7 13.8 241
CALVERT INCOME A	B+	CL	A	1053.6	123	3.75**	1.08†	14.2 8.7 9.8	8.0 15.1 111
COLUMBIA FIXED INCOME SECURITIES	B	CI	B	473.5	26	No load	0.86	8.1 6.1 7.1	5.8 16.7 212
COMMERCE BOND INSTL.	C	CI	C	732.8	122	No load	0.81	8.5 5.7 5.8	6.0 17.7 212
DODGE & COX INCOME	B	CL	A	1477.8	52	No load	0.48	10.3 8.6 7.6	8.0 14.1 112
DREYFUS A BONDS PLUS	C	CI	D	597.1	6	No load	0.91	4.6 5.5 5.7	6.7 14.7 251
DREYFUS GNMA	B	GI	C	988.1	5	No load	0.80†	7.7 6.4 6.5	5.8 21.0 352
DREYFUS INV. GRD. INTERM.-TERM INC.	B+	CI	A	556.7	428	No load	0.67	6.2 7.9 9.2	8.5 12.9 111
DREYFUS INV. GRD. SH.-TERM INC.	B+	GS	C	1042.3	117	No load	0.84	6.3 7.1 6.8	6.3 10.5 451
DREYFUS PREMIER CORE BOND A	C	CI	C-	919.7	137	4.50**	1.00	5.7 6.6 7.0	6.4 16.6 151
DREYFUS SHORT-INTERM. GOVT.	B+	GS	D	482.3	31	No load	0.71	6.0 5.6 5.9	4.4 4.1 521

* Includes redemption fee. ** Includes deferred sales charge. † 12(b)-1 plan in effect. NA = Not available.

(a) Formerly American Century:GNMA Fund/Inv.

Data: Standard & P

MUTUAL FUND SCOREBOARD

Bond Funds

FUND	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY (RATING COMPARES FUND WITHIN CATEGORY)	RATING	SIZE ASSETS \$ MIL.	% CHG. 2000-2001	FEES		PERFORMANCE			PORTFOLIO		HISTORY RESULTS VS. ALL FUNDS
						SALES CHARGE (%)	EXPENSE RATIO (%)	TOTAL RETURN (%)			YIELD (%)	MATURITY (YEARS)	
TON VANCE HIGH-INCOME B	D	HY	C-	676.3	3	0.00**	1.78†	-2.4	-2.3	1.8	12.5	7.3	151555
TON VANCE INC. FUND OF BOSTON A	D	HY	C	815.7	30	4.75**	1.06†	-0.1	1.3	4.5	12.4	7.4	151555
TON VANCE INSTL. SH-TERM TREASURY		GS		785.9	17	No load	0.60	3.9	NA	NA	1.1	4.8	54
TON VANCE PRIME RATE RESERVES	B+	UB	C-	3143.3	-21	0.00**	1.24†	2.5	4.1	5.2	6.3	4.0	521555
TERATED FUND FOR U.S. GOVT. SECS. A	B	GS	F	910.8	0	4.50	1.03	7.3	6.0	6.5	5.9	20.3	322332
TERATED GNMA TRUST INSTL.	B+	GI	B+	793.2	4	No load	0.64	7.3	5.2	5.8	6.1	25.4	323222
TERATED GOVT. INCOME SECS. F	C	GI	C-	815.8	-6	1.00**	0.98	5.3	5.2	5.5	5.9	22.6	213222
TERATED HIGH-INCOME BOND B	D	HY	C-	908.8	1	0.00**	1.99†	-0.8	-3.3	0.6	10.8	7.3	151555
TERATED HIGH-YIELD TRUST	D	HY	C	602.3	10	No load	0.88	-1.8	-3.2	0.7	11.8	7.3	151555
TERATED INCOME TRUST INSTL.	B+	GI	A	582.9	-5	No load	0.58	11.0	5.6	7.0	6.1	20.4	313331
TERATED LIMITED-TERM A	B+	CS	D	434.0	282	1.00	1.17†	7.1	5.1	5.4	5.3	2.3	321332
TERATED STRATEGIC INCOME B	D	MU	C	592.5	2	0.00**	1.94†	5.4	2.0	3.1	9.1	12.1	451553
TERATED ULTRA-SHORT		UB		762.8	342	No load	0.80†	5.7	5.7	NA	5.6	1.5	2142
TERATED U.S. GOVT. SECS. 2-5 YR. INSTL.	B	GI	B	611.0	15	No load	0.57	8.3	5.9	5.6	5.1	3.5	412331
ELITY ADVISOR HIGH-YIELD T	F	HY	D	1545.8	-4	3.50**	1.05†	-0.2	-1.3	1.8	10.2	6.5	151553
ELITY ADVISOR INTERM. BOND T	B	CI	B	538.0	68	2.75**	0.97†	7.8	5.8	6.3	5.4	5.2	522331
ELITY CAPITAL & INCOME	D	HY	C-	2839.8	3	0.00*	0.78	-5.1	-0.9	3.2	8.5	4.5	151555
ELITY CONVERTIBLE SECURITIES	F	CV	C	1733.4	-6	No load	0.77	0.5	15.8	15.6	4.7	NA	111444
ELITY GINNIE MAE	B+	GI	B+	4009.6	123	No load	0.62	7.3	6.3	6.8	5.8	5.2	322222
ELITY GOVERNMENT INCOME	C	GI	C	2355.1	46	No load	0.60	5.8	5.5	5.8	5.5	9.2	313312
ELITY HIGH-INCOME	D	HY	C-	1599.5	-25	0.00*	0.74	-3.5	-3.4	1.6	12.4	5.3	151555
ELITY INTERMEDIATE BOND	B+	CI	A	4786.9	43	No load	0.63	8.8	6.4	6.8	5.7	5.5	422331
ELITY INTERMEDIATE GOVT. INC.	B+	GI	B+	945.8	26	No load	0.60	8.0	6.3	6.7	5.8	4.3	412331
ELITY INVESTMENT-GRADE BOND	B	CI	B	3636.4	52	No load	0.64	8.5	6.0	7.0	5.6	7.2	312221
ELITY MORTGAGE SECURITIES INITIAL	B+	GI	A	424.6	14	No load	0.66	7.7	6.9	7.1	6.0	4.1	231221
ELITY SHORT-TERM BOND	A	CS	B	3620.4	120	No load	0.58	7.6	6.2	6.2	5.3	2.4	531411
ELITY SPARTAN GOVT. INCOME	C	GI	C	909.8	35	No load	0.49	6.9	5.5	7.0	5.5	8.8	213312
ELITY SPARTAN INVESTMENT-GRADE BOND	B	CI	B+	2516.5	37	No load	0.50	8.8	6.2	7.3	5.7	6.5	212221
ST AMERICAN BOND IMMDEX Y (b)	C	CI	C	645.5	31	No load	0.48	6.8	5.6	7.1	5.8	12.0	213312
ST AMERICAN FIXED-INCOME Y	C	CI	C	1346.1	4	No load	0.88	8.1	5.3	6.7	5.7	13.1	314221
ST AMERICAN INTERM.-TERM BOND Y (c)	B+	CI	A	882.3	98	No load	0.50	7.7	5.2	5.8	5.5	8.2	412331
ST INVESTORS FUND FOR INCOME A	D	HY	B	431.5	-6	6.25**	1.30†	1.6	-0.2	2.9	11.6	5.9	151555
ANKLIN AGE HIGH-INC. A	D	HY	C	2078.0	-2	4.25**	0.76†	2.9	-1.4	1.7	11.1	7.4	162332
ANKLIN U.S. GOVT. SECS. A	B+	GI	B+	7224.7	5	4.25**	0.68†	7.7	5.3	7.0	6.1	24.6	222331
ANMONT BOND	B	CI	B	856.8	235	No load	1.83	9.7	5.6	7.9	5.5	15.3	413111
LAXY HIGH-QUALITY BOND TRUST	C	CL	C	822.7	45	No load	0.73	7.5	5.3	6.9	5.5	12.6	214111
LAXY INTERM. GOVT. INC. TRUST	B	GI	B	470.7	4	No load	0.69	7.7	5.8	6.8	5.4	11.1	213221
Q EMERGING-COUNTRY DEBT IV		EB		490.5	-20	No load	0.51†	14.4	23.4	NA	13.9	17.0	111
LDMAN SACHS HIGH-YIELD A		HY		594.9	63	4.50**	1.16†	5.5	1.7	NA	10.3	NA	31332
IN HANCOCK BOND A	C	CL	C	1166.6	5	4.50**	1.12†	7.1	5.3	6.5	5.8	12.5	223332
IN HANCOCK GOVERNMENT INCOME A	C	GI	D	540.9	6	4.50**	1.02†	6.7	5.3	5.8	5.6	19.3	313312
IN HANCOCK HIGH-YIELD BOND B	F	HY	D	491.7	-13	0.00**	1.68†	0.1	0.2	0.8	11.7	5.2	151555
IN HANCOCK STRATEGIC INCOME B	C-	MU	B	567.9	7	0.00**	1.63†	4.2	2.3	4.6	7.6	9.4	151555
RBOR BOND	B	CI	B+	1024.3	37	No load	0.60	9.0	6.6	7.7	4.6	7.0	212221
TESCO HIGH-YIELD INV.	F	HY	F	420.5	-36	0.00*	1.08†	-19.0	-8.0	-1.8	15.1	6.1	151555
TESCO SELECT INCOME INV.	C-	HY	B+	495.0	-11	No load	1.05†	-2.9	0.2	3.8	7.4	8.2	123355
ERMEDIATE BOND FD. OF AMERICA A	B	CI	B+	1908.9	43	3.75**	0.81†	6.9	6.0	6.3	5.5	12.1	322332
IUS FLEXIBLE INCOME	C	MU	A	1295.1	22	No load	0.79	7.2	4.2	6.5	6.2	6.7	112355
IUS HIGH-YIELD	C-	HY	B+	424.4	47	No load	1.00	4.6	4.2	5.7	8.1	5.1	151555
IUS SHORT-TERM BOND	A	CS	B	506.7	230	No load	0.65	6.9	5.8	6.2	4.6	2.1	321455
ERTY FEDERAL SECURITIES A	C-	GL	C	575.9	-1	4.75**	1.15†	6.7	4.7	5.8	5.4	8.8	213312
ERTY INTERM. GOVERNMENT A	C	GI	D	566.2	13	4.75**	1.18†	5.9	5.0	6.3	5.2	5.8	313332
ERTY STRATEGIC INCOME A	C-	MU	C	578.6	9	4.75**	1.17†	3.1	1.2	3.5	9.1	10.8	142331
INST. WESTERN ASSET CORE PORT. INSTL.	B	CL	A	909.5	25	No load	0.50	10.1	5.9	7.8	5.8	11.8	113311
INST. WESTERN ASSET INTERM. INSTL.	B	CI	B+	629.6	42	No load	0.45	7.8	6.2	6.9	5.4	8.8	312221
RD ABBETT BOND DEBENTURE A	C-	HY	B+	2495.2	23	4.75**	1.00†	4.9	2.6	5.0	8.6	9.0	151555
RD ABBETT U.S. GOVT. SECS. A	C	GI	D	1092.6	-3	4.75**	1.11†	7.0	5.3	5.6	5.7	19.6	213332
S. DIVERSIFIED INCOME B (d)	D	MU	C-	444.6	-17	0.00**	1.38†	-5.8	-5.8	-1.9	8.3	10.9	554555
S. FEDERAL SECURITIES B (e)	C-	GL	C	469.4	0	0.00**	1.57†	5.7	3.9	5.9	5.1	14.5	313332
S. HIGH-YIELD SECURITIES B (f)		HY		541.2	-45	0.00**	1.37†	-27.6	-20.2	NA	21.2	7.5	51555
S. INSTL. FIXED-INC. (g)	B	CL	A	4112.2	2	No load	0.48	10.4	6.7	7.3	6.5	19.2	222331
S. INSTL. HIGH-YIELD (h)	D	HY	C-	590.7	-23	No load	0.57	-5.8	-3.1	1.7	13.9	7.3	151555
S. SHORT-TERM U.S. TREAS. TR. (i)	B+	GS	C-	397.4	55	No load	0.74†	5.6	5.2	5.7	5.0	1.8	522422
S. U.S. GOVT. SECS. TR. B (j)	B	GI	C	4119.6	12	0.00**	0.72†	6.3	5.5	6.5	5.6	16.9	322331
INSTAY CONVERTIBLE B	D	CV	B	583.0	-11	0.00**	1.99†	-4.8	10.5	8.4	2.4	10.5	151555
INSTAY GOVERNMENT B	C-	GL	C	418.4	6	0.00**	1.91†	5.5	4.3	5.8	4.7	13.0	314222
INSTAY HIGH-YIELD CORP. B	D	HY	B	2475.8	-6	0.00**	1.78†	1.7	1.1	3.2	11.6	7.5	151555
IRSHALL INTERMEDIATE BOND INV.	B	CI	B+	524.4	1	No load	0.72	8.0	5.4	5.9	5.7	8.4	422422
RRILL LYNCH BOND HIGH-INCOME B (k)	F	HY	C-	1360.4	-23	0.00**	1.37†	-0.6	-2.3	-0.2	11.9	5.8	151555
RRILL LYNCH CORE BOND A (l)	C-	CL	C-	531.8	8	4.00**	0.61	7.3	4.8	5.0	5.4	14.0	313332

Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available.
 (a) Formerly Firststar Bond IMMDEX Fund/Instl. (c) Formerly Firststar Interim. Bond Mkt. Fund/Instl. (d) Formerly Morg. Stan. Dean Witter Divers. Inc./B. (e) Formerly Morg. Stan. Dean Witter Federal Sec. Tr/B. (f) Formerly Morg. Stan. Dean Witter H/Y Sec./B. (g) Formerly MAS Fds.: Fixed-Inc. Port/Instl. (h) Formerly MAS Fds.:HY Port/Instl. (i) Formerly Morg. Stan. Dean Witter S/T U.S. Treas. (j) Formerly Morgan Stanley Dean Witter U.S. Govt. Sec. Tr/B. (k) Formerly Merrill Lynch Corp. Bond: High Inc./B. (l) Formerly Merrill Lynch Corp. Bond Fund: Inv. Grade/A.
 Data: Standard & Poor's

Your people are hounding y



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MUTUAL FUND SCOREBOARD

Bond Fund

FUND	RATING	CATEGORY	RATING	SIZE	FEES	PERFORMANCE	PORTFOLIO	HIST			
(COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)				ASSETS \$ MIL.	% CHG. 2000-2001	SALES CHARGE (%)	EXPENSE RATIO (%)	TOTAL RETURN (%) 1 YR. 3 YR. 5 YR.	YIELD (%)	MATURITY (YEARS)	RES. ALL
MERRILL LYNCH U.S. GOVT. MORTGAGE B	B	GI	B	529.2	33	0.00**	1.52†	7.0 5.7 6.1	4.9	22.2	439
METROPOLITAN WEST TOTAL RETURN BOND M		CI		521.5	155	No load	0.85†	9.2 7.1 NA	7.5	NA	11
MFS BOND A	C-	CL	C-	987.2	33	4.75**	0.93†	7.8 4.7 5.8	6.7	14.9	151
MFS GOVERNMENT MORTGAGE A	B	GI	C	555.1	5	4.75**	0.91†	6.6 5.7 6.4	5.7	24.4	331
MFS GOVERNMENT SECURITIES A	C	GL	B	543.7	44	4.75**	0.93†	6.4 5.2 6.6	5.5	18.0	211
MFS HIGH-INCOME A	D	HY	C	759.8	18	4.75**	1.00†	1.2 0.2 2.8	10.7	7.0	151
J.P. MORGAN BOND INSTL. (m)	B	CL	B+	1003.2	8	No load	0.50	7.0 5.7 6.8	5.3	11.9	211
J.P. MORGAN SHORT-TERM BOND INSTL. (n)	A	CI	A	690.9	63	No load	0.29	7.3 5.9 6.2	4.8	7.4	521
MPAM BOND MPAM (o)		CL		963.9	55	No load	0.56	8.2 NA NA	5.7	11.6	
MPAM INTERMEDIATE BOND MPAM (p)		CI		401.3	2	No load	0.56	8.3 NA NA	5.5	6.5	
NORTHEAST INVESTORS	D	HY	B	1250.4	5	No load	0.21	1.3 -0.5 2.3	11.7	5.8	151
NORTHERN FIXED-INCOME	C	CI	C-	748.1	4	No load	0.90	5.9 4.5 6.1	5.9	15.3	211
OFFITBANK HIGH-YIELD SELECT	D	HY	B	810.1	-17	No load	0.86	4.1 0.3 3.4	10.2	6.3	151
ONE GROUP SHORT-TERM BOND I	A	CS	C	733.5	5	No load	0.55	6.1 6.2 6.4	5.4	2.1	521
OPPENHEIMER CHAMPION INCOME A	D	HY	B	736.2	21	4.75**	1.07†	1.6 1.2 3.1	10.2	5.7	151
OPPENHEIMER HIGH-YIELD A	D	HY	C	968.6	3	4.75**	1.00†	-0.1 0.0 2.3	12.0	4.6	151
OPPENHEIMER LTD.-TERM GOVERNMENT A	B+	GS	C-	819.2	29	3.50**	0.85†	6.9 5.5 6.2	5.2	1.0	321
OPPENHEIMER STRATEGIC INCOME A	C-	MU	C	3285.8	0	4.75**	0.93†	3.5 3.3 3.9	9.4	4.0	351
OPPENHEIMER U.S. GOVT. TR. A	C	GI	C	642.6	13	4.75**	0.91†	6.9 5.4 6.6	5.3	2.8	121
PILGRIM GNMA INCOME A	B	GI	B	503.0	39	4.75	1.16†	6.5 6.4 7.4	5.2	26.2	111
PILGRIM PRIME RATE	C	UB	F	1001.4	-10	No load	1.81	-2.1 1.0 3.9	9.0	NA	311
PIMCO HIGH-YIELD C		HY		448.3	52	0.00**	1.65†	5.1 1.7 NA	8.8	NA	41
PIMCO LOW DURATION A		CS		622.4	149	3.00**	0.96†	7.7 5.8 NA	5.4	10.1	21
PIMCO REAL RETURN BOND A		GL		406.4	764	3.00**	0.94†	8.8 8.7 NA	6.0	NA	51
PIMCO SHORT-TERM A		UB		505.1	533	2.00**	1.41†	5.2 5.6 NA	4.5	9.0	41
PIMCO TOTAL RETURN A		CI		4114.4	72	4.50**	0.96†	9.0 6.5 NA	4.8	12.6	11
PIONEER HIGH-YIELD A		HY		455.7	642	4.50**	0.98†	16.7 17.7 NA	9.1	5.0	1
T. ROWE PRICE GNMA	B	GI	B	1139.8	6	No load	0.70	7.7 6.2 6.9	5.9	3.2	221
T. ROWE PRICE HIGH-YIELD	C-	HY	B+	1568.9	11	0.00*	0.82	6.1 2.3 5.0	10.3	7.5	121
T. ROWE PRICE INTL. BOND	F	IB	D	785.5	13	No load	1.15	-3.4 -4.8 -0.8	4.1	9.0	511
T. ROWE PRICE NEW INCOME	C	CI	C-	1819.0	6	No load	0.73	8.1 5.8 6.3	5.7	7.7	241
T. ROWE PRICE SHORT-TERM BOND	A	CS	C	589.1	25	No load	0.59	8.5 6.4 6.3	5.6	2.3	231
T. ROWE PRICE SPECTRUM INCOME	C-	MU	B+	2478.3	5	No load	0.77	4.0 4.0 6.1	6.0	7.9	121
PRUDENTIAL GOVERNMENT INCOME A	C	GI	D	893.7	23	4.00	0.75†	7.6 5.2 6.7	5.3	7.2	211
PRUDENTIAL HIGH-YIELD A	D	HY	C	1288.1	-17	4.00	0.60†	-0.2 -1.4 1.6	10.9	6.3	151
PUTNAM AMERICAN GOVT. INC. A	C	GI	D	1436.6	1	4.75**	0.99†	5.9 4.8 5.4	4.8	NA	211
PUTNAM CONV. INCOME GROWTH TR. A	F	CV	C-	587.7	-18	5.75**	0.97†	-8.1 -0.4 4.4	4.3	7.4	151
PUTNAM DIVERSIFIED INCOME TR. M	D	MU	C-	1554.0	64	3.25	1.20†	3.4 1.6 2.1	8.8	NA	451
PUTNAM HIGH-YIELD ADVANTAGE M	D	HY	C-	894.1	30	3.25	1.20†	3.1 -0.3 0.2	11.9	7.6	151
PUTNAM HIGH-YIELD TR. A	D	HY	C-	1489.9	-13	4.75**	0.99†	3.4 0.0 1.1	12.2	7.7	151
PUTNAM HIGH-YIELD TRUST II B		HY		687.1	5	0.00**	1.80†	3.4 -0.9 NA	11.9	7.7	
PUTNAM INCOME A	C-	CL	C-	1232.8	27	4.75**	0.95†	7.8 4.4 5.0	5.5	19.7	351
PUTNAM U.S. GOVT. INCOME TR. A	B	GI	C	2260.9	14	4.75**	0.86†	6.9 5.7 6.5	5.4	NA	321
FRANK RUSSELL DIVERSIFIED BOND S	B	CI	B	723.0	1	No load	0.62	8.0 5.9 7.0	5.3	6.7	211
FRANK RUSSELL INSTL. FIXED-INCOME I I	B	CI	B+	808.2	-13	No load	0.40	8.1 6.1 7.2	5.6	6.3	211
FRANK RUSSELL INSTL. FIXED-INCOME 3 I	B	CI	B	399.1	-12	No load	0.73	7.6 5.8 6.7	7.2	6.3	221
FRANK RUSSELL MULTI-STRATEGY BOND S	C	CI	C	610.2	3	No load	0.86	7.6 5.4 6.5	6.3	6.3	221
FRANK RUSSELL SHORT-TERM BOND S	A	CS	B	430.2	3	No load	0.64	8.3 6.3 6.2	5.6	2.8	631
SCHWAB SHORT-TERM BOND MKT. INDEX	B+	GS	C-	410.9	88	No load	0.35	7.3 5.9 6.3	5.6	2.9	121
SCHWAB TOTAL BOND MARKET INDEX	C	CL	B	966.8	40	No load	0.35	6.2 6.0 7.2	5.5	11.1	111
SCHWAB YIELD-PLUS SELECT		CS		1235.0	373	0.00*	0.40	6.0 NA NA	5.7	0.6	
SCUDDER GNMA AARP	B+	GI	B+	3860.6	5	No load	0.73	7.1 5.9 6.5	6.0	24.6	421
SCUDDER HIGH-YIELD A (q)	D	HY	C	2204.6	11	4.50**	1.09	3.4 -1.3 1.6	12.2	5.3	151
SCUDDER INCOME S	C	CI	C-	700.3	-1	No load	0.95	5.9 4.8 5.7	5.9	9.4	331
SCUDDER SHORT-TERM BOND S	B+	CS	D	541.5	-1	No load	0.84	6.6 5.2 5.2	5.5	6.8	551
SCUDDER U.S. GOVT. SECS. A (r)	B	GI	C	3819.9	56	4.50**	0.79	7.2 5.9 6.7	5.8	4.7	221
SEI EMERGING MARKETS DEBT A		EM		469.5	-3	No load	1.35	12.3 10.0 NA	11.2	23.9	51
SEI INTERNATIONAL FIXED-INCOME A	F	IB	D	1124.8	-1	No load	1.00	-5.2 -5.2 -0.6	0.0	6.1	511
SELIGMAN HIGH-YIELD BOND B	F	HY	D	504.4	-32	0.00**	1.84†	-16.6 -9.5 -3.3	14.3	NA	151
SMITH BARNEY DIVERSIFIED STRAT. INC. B	C-	MU	B+	701.6	-29	0.00**	1.53†	1.4 1.0 3.0	7.1	13.6	341
SMITH BARNEY HIGH-INCOME B	D	HY	C-	428.3	-12	0.00**	1.56†	-5.2 -4.2 -0.3	12.7	NA	151
STANDISH FIXED-INCOME	C	CI	C-	1613.3	-30	No load	0.35	7.2 5.5 6.2	6.9	10.5	341
STANDISH INTL. FIXED-INCOME INSTL.	B	IB	B+	437.4	-28	No load	0.53	4.1 4.8 5.9	1.6	14.7	111
STATE STREET RESEARCH GOVT. INC. A	C	GI	C-	504.6	4	4.50**	1.13†	6.7 4.7 6.5	5.5	7.0	311
STEINROE INCOME INTERM. BOND S (s)	B	CI	B+	637.3	46	No load	0.36	9.1 7.0 7.3	6.7	7.8	221
STRONG ADVANTAGE INV.	A	UB	B	3035.0	42	No load	0.80	4.3 5.4 5.5	5.7	0.0	111
STRONG CORPORATE BOND INV.	C-	CL	C	1286.2	38	No load	0.90	6.9 4.8 6.7	7.1	13.7	151
STRONG GOVERNMENT SECURITIES INV.	B	GL	B+	1851.8	27	No load	0.90	6.7 5.2 7.1	5.0	5.4	311
STRONG HIGH-YIELD BOND INV.	D	HY	C	934.6	49	0.00*	0.90	-0.7 -0.2 3.5	12.4	5.0	151
STRONG SHORT-TERM BOND INV.	B+	CS	C-	1332.6	17	No load	0.90	4.5 5.3 5.6	6.3	2.4	441

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available.

(m) Formerly J.P. Morgan Institutional Bond Fund. (n) Formerly J.P. Morgan Institutional Short Term Bond Fund. (o) Formerly MPAM Bond Fund. (p) Formerly MPAM Intermediate Bond Fund. (q) Formerly Kemper High-Yield Fund/A. (r) Formerly Kemper U.S. Government Securities Fund/A. (s) Formerly SteinRoe Income Trust: Intermediate Bond Fund.

Data: Standard &

MUTUAL FUND SCOREBOARD

Bond Funds

	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY (RATING COMPARES FUND WITHIN CATEGORY)	RATING	SIZE ASSETS \$ MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	PERFORMANCE TOTAL RETURN (%)			PORTFOLIO		HISTORY RESULTS VS. ALL FUNDS
								1 YR.	3 YR.	5 YR.	YIELD (%)	MATURITY (YEARS)	
GOVERNMENT SECURITIES A	C	GI	C	1525.0	34	3.75**	0.95†	8.4	5.4	6.5	4.7	12.9	313112
AMERICA GNMA	C	GI	C-	537.6	25	No load	0.32	7.1	5.0	6.6	6.1	10.4	214112
AMERICA INCOME	C	GI	B-	1577.2	20	No load	0.41	7.6	5.4	7.2	6.6	11.5	114111
AMERICA SHORT-TERM BOND	B+	CS	D	488.4	50	No load	0.46	5.1	5.4	5.7	6.6	3.0	441443
KAMPEL GOVERNMENT SECURITIES A	C	GI	D	1341.3	-3	4.75**	1.02†	8.4	5.0	6.5	4.6	17.5	214112
KAMPEL HARBOR A	F	CV	D	482.9	-18	5.75**	1.02†	-14.4	8.0	9.6	2.6	12.4	111155
KAMPEL U.S. GOVERNMENT A	B	GI	C	1564.4	-1	4.75**	0.92†	8.2	6.0	6.5	5.3	22.0	332311
GUARD BOND INDEX LONG	C-	CL	D	549.8	40	No load	0.21	8.1	5.1	8.2	8.2	22.5	115111
GUARD GNMA	B+	GI	A	15698.0	15	No load	0.27	7.9	6.6	7.2	6.3	4.1	222211
GUARD HIGH-YIELD CORP.	C-	HY	B+	5335.7	3	0.00*	0.27	2.9	1.5	4.3	9.5	6.0	131155
GUARD INFLATION-PROTECTED SECS.		GI		707.5	441	No load	0.25	7.6	NA	NA	4.2	14.4	1
GUARD INTERMEDIATE CORP. BOND	C	CI	C-	2064.3	12	No load	0.22	9.4	6.1	7.1	6.5	7.3	313121
GUARD INTERM.-TERM BOND INDEX	C	CI	C	2177.9	39	No load	0.21	9.3	6.1	7.6	6.3	7.8	214111
GUARD INTERM.-TERM TREAS. INV.	C	GI	C-	2035.2	19	No load	0.26	7.5	5.8	7.4	5.7	7.9	314111
GUARD LONG-TERM CORP.	C-	CL	D	3646.6	-1	No load	0.30	9.6	4.7	7.4	6.5	23.4	115111
GUARD LONG-TERM U.S. TREASURY	C-	GL	C-	1406.0	9	No load	0.29	4.3	4.5	11.0	5.6	20.2	115114
GUARD SHORT-TERM BOND INDEX	A	CS	C	1793.5	43	No load	0.21	8.8	6.6	6.9	5.5	2.8	411141
GUARD SHORT-TERM CORP.	A	CS	C	7353.8	2	No load	0.24	8.1	6.5	6.8	6.3	2.9	521441
GUARD SHORT-TERM FEDERAL	A	GS	B+	1784.4	20	No load	0.28	8.6	6.6	6.7	5.2	2.7	521131
GUARD SHORT-TERM U.S. TREASURY	B+	GS	C	1379.6	17	No load	0.27	7.8	6.1	6.4	4.9	3.1	521441
GUARD TOTAL BOND MARKET INDEX	B	GI	B	14262.8	33	No load	0.22	8.3	6.2	7.3	6.2	9.3	212211
DELL & REED ADV. BOND A	C	CI	C-	610.1	22	5.75	1.01†	7.5	5.1	5.4	5.1	9.6	223331
DELL & REED ADV. HIGH-INCOME A	C-	HY	B+	746.0	8	5.75	1.08†	6.7	0.9	4.1	8.1	5.1	151152
LS FARGO INCOME I	C-	CL	C-	540.2	12	No load	0.75	6.9	4.5	6.5	6.1	10.4	114122
LS FARGO INTERM. GOVT. INCOME I	C	GI	C-	434.1	10	No load	0.66	6.9	5.2	5.8	6.0	7.9	311122
TAX-EXEMPT													
TAX-FREE INTERMEDIATE SHARES	A	MI	B	855.6	93	1.00**	0.41	4.5	4.2	5.1	4.2	9.3	442444
VANCE MUNI. INCOME CA. A	C	MC	B	754.6	5	4.25**	0.84†	3.8	3.3	5.4	4.6	25.0	124125
VANCE MUNI. INCOME NATL. A	C-	ML	C	418.9	4	4.25**	0.66†	4.4	2.5	4.6	4.0	24.0	135334
RICENTURY CA. INTERM. TAX-FREE INV.	B+	MF	C	448.1	1	No load	0.51	4.3	4.4	5.3	4.3	8.8	443114
AMERICAN HIGH-INCOME MUNI. BOND A	B+	MH	B+	892.7	21	3.75**	0.80†	6.2	3.6	5.2	5.4	17.1	153442
AMERICAN HIGH-YIELD TAX-EXEMPT A	C	MH	C	4645.4	1	4.75**	0.79†	3.9	3.4	5.0	5.5	17.6	244334
AMERICAN INSURED TAX-EXEMPT A	C-	ML	C	399.2	8	4.75	0.82†	3.7	3.8	4.9	4.3	18.2	444115
AMERICAN MUNI. TAX-EXEMPT A	C	SL	B	370.0	9	4.75	0.84†	4.9	3.6	5.0	5.0	18.7	334333
TAX-EXEMPT BOND A	C-	ML	C	866.3	7	4.75	0.82†	3.8	3.7	5.3	4.3	11.2	245114
AMERICAN VERT TAX-FREE RSV. LTD.-TERM A	A	MS	B	664.5	43	1.00	0.70	4.5	4.0	4.0	4.1	13.2	551154
AMERICAN UMBIA OREGON MUNICIPAL BOND	B	SL	B+	492.2	14	No load	0.58	4.6	3.8	5.0	4.7	13.7	343333
AMERICAN AWARE TAX-FREE MN. A	C-	SL	C	353.2	-1	3.75**	1.00†	4.2	3.2	5.0	4.9	13.3	315214
AMERICAN AWARE TAX-FREE PA. A	D	SL	D	682.0	-1	3.75**	0.92†	5.0	3.0	4.3	4.1	22.5	445115
AMERICAN AWARE TAX-FREE U.S.A. A	D	ML	C-	499.9	21	3.75**	0.88†	4.4	3.1	4.5	5.1	23.8	455214
AMERICAN YFUS CA. TAX-EXEMPT BOND	C-	MC	C	1122.7	2	0.00*	0.70	3.5	4.5	5.5	4.7	22.9	435115
AMERICAN YFUS GENERAL MUNI. BOND	D	ML	C-	412.7	-2	0.00*	0.87†	2.4	2.5	4.1	5.4	23.3	445215
AMERICAN YFUS INTERM. MUNI. BOND	B	MI	C	1059.5	0	0.00*	1.01	4.0	3.3	4.6	4.9	10.0	443114
AMERICAN YFUS MUNI. BOND	D	ML	C-	2538.0	-1	0.00*	0.72	2.7	2.6	4.3	5.3	20.5	425115
AMERICAN YFUS N.J. MUNI. BOND	C	SL	B	553.1	8	0.00*	0.85†	4.2	3.6	5.1	5.0	18.3	334214
AMERICAN YFUS N.Y. TAX-EXEMPT BOND	B	MY	B+	1485.7	5	0.00*	0.73	4.8	3.8	5.4	4.9	18.0	224213
AMERICAN YFUS PREMIER MUNI. BOND A	F	ML	F	388.3	5	4.50**	0.98	3.1	1.7	3.8	5.0	21.1	255115
AMERICAN YFUS SHORT-INTERM. MUNI. BOND	A	MS	C	353.7	35	0.00*	0.71†	4.7	3.9	4.3	4.2	11.7	551153
AMERICAN FREE KY. TAX-FREE INCOME	B	SL	B+	501.6	15	No load	0.60	5.1	3.8	5.0	5.0	15.5	433443
AMERICAN VANCE NATL. MUNICIPAL B	F	ML	F	1508.8	2	0.00**	0.48†	3.1	1.7	4.5	5.6	23.2	155215
AMERICAN VANCE NATL. MUNICIPAL BOND A		ML		832.8	-5	4.75**	0.85†	3.8	2.4	NA	4.4	NA	534
AMERICAN VANCE NATL. INTERM.-TERM TAX-EXEMPT	B	MI	C-	387.0	27	No load	0.57	4.1	3.8	5.0	3.8	NA	423334
AMERICAN VANCE NATL. INTERM. SECS. A	F	ML	F	455.8	1	4.50**	0.88	3.5	2.5	4.4	4.4	14.7	245215
AMERICAN VANCE NATL. ADVISOR MUNICIPAL INC. T	B	ML	B+	361.9	6	3.50**	0.72†	4.6	4.4	5.8	4.4	15.2	234213
AMERICAN VANCE NATL. SPARTAN CA. MUNI. INC.	B+	MC	A	1640.3	19	0.00*	0.42	4.7	4.6	5.0	4.5	13.8	224113
AMERICAN VANCE NATL. SPARTAN CT. MUNI. INC.	B+	SL	A	415.3	20	0.00*	0.42	5.3	4.8	5.7	5.0	12.5	233113
AMERICAN VANCE NATL. SPARTAN FL. MUNI. INC.	B+	SL	A	502.1	22	0.00*	0.49	5.2	4.3	5.6	4.8	12.3	324213
AMERICAN VANCE NATL. SPARTAN INTERM. MUNI. INC.	A	MI	B+	1533.1	31	0.00*	0.49	5.4	4.4	5.5	4.7	7.7	333333
AMERICAN VANCE NATL. SPARTAN MA. MUNI. INC.	B+	SL	A	1960.5	32	0.00*	0.42	4.4	4.8	5.7	4.7	15.0	243114
AMERICAN VANCE NATL. SPARTAN MI. MUNI. INC.	B	SL	B+	519.8	17	0.00*	0.45	4.8	4.3	5.4	4.8	13.3	323113
AMERICAN VANCE NATL. SPARTAN MN. INC.	B+	MH	B+	4623.5	8	0.00*	0.48	5.0	4.8	5.8	4.8	14.7	333114
AMERICAN VANCE NATL. SPARTAN N.J. MUNI. INC.	B+	SL	A	513.8	34	0.00*	0.45	4.6	4.7	5.6	5.0	14.6	333213
AMERICAN VANCE NATL. SPARTAN N.Y. MUNI. INC.	B	MY	B+	1352.6	24	0.00*	0.42	4.4	4.4	5.9	4.8	14.9	224114
AMERICAN VANCE NATL. SPARTAN OH. MUNI. INC.	B	SL	B+	412.8	13	0.00*	0.46	4.7	4.4	5.5	4.7	13.7	334213
AMERICAN VANCE NATL. SPARTAN SH. INTERM. MUNI. INC.	A	MI	A	1258.8	36	0.00*	0.45	5.7	4.5	4.7	3.8	3.0	551152
AMERICAN VANCE NATL. SPARTAN TAX-FREE Y (a)	C	ML	B	501.1	24	No load	0.73	4.1	3.8	5.5	4.3	14.1	135114
AMERICAN VANCE NATL. SPARTAN TAX-EXEMPT A	F	ML	D	918.2	0	6.25**	1.12†	3.5	3.9	5.1	4.3	13.0	344115
AMERICAN VANCE NATL. SPARTAN AZ. TAX-FREE INC. A	C-	SL	C-	871.1	15	4.25**	0.64†	3.0	3.0	4.5	5.1	20.6	344333
AMERICAN VANCE NATL. SPARTAN CA. HIGH-YIELD MUNI. A	C	MC	C	509.9	8	4.25**	0.50†	5.4	3.0	5.6	5.5	24.3	125215

Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available.
Formerly Firststar National Municipal Bond Fund/Instl.

Data: Standard & Poor's

MUTUAL FUND SCOREBOARD

Bond Fun

FUND	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY (RATING COMPARES FUND WITHIN CATEGORY)	RATING	SIZE ASSETS \$ MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	PERFORMANCE TOTAL RETURN (%)			PORTFOLIO		HISTO RESUL ALL F
								1 YR.	3 YR.	5 YR.	YIELD (%)	MATURITY (YEARS)	
FRANKLIN CA. INS. TAX-FREE INC. A	C	MC	B+	1747.3	10	4.25**	0.61†	4.6	4.3	5.5	4.7	21.6	424
FRANKLIN CA. TAX-FREE INC. A	C	MC	B	13412.0	4	4.25**	0.57†	5.4	4.3	5.6	4.9	21.7	323
FRANKLIN FEDERAL TAX-FREE INC. A	B	ML	B+	5688.5	6	4.25**	0.60†	4.6	3.9	5.3	5.1	19.5	234
FRANKLIN FL. TAX-FREE INC. A	B	SL	B+	1583.5	7	4.25**	0.62†	5.3	4.1	5.4	5.0	20.3	424
FRANKLIN HIGH-YIELD TAX-FREE INC. A	C	MH	C	4876.0	-3	4.25**	0.62†	5.9	2.8	4.7	5.3	18.7	154
FRANKLIN INSURED TAX-FREE INC. A	C	ML	B	1533.0	7	4.25**	0.62†	4.6	4.2	5.4	4.8	18.8	434
FRANKLIN MA. INSURED TAX-FREE A	C	SL	C	371.9	19	4.25**	0.70†	4.2	4.3	5.4	4.7	22.2	344
FRANKLIN MI. INS. TAX-FREE INC. A	B	SL	B+	1169.3	12	4.25**	0.64†	4.8	4.4	5.5	4.7	16.1	423
FRANKLIN MN. INS. TAX-FREE INC. A	C	SL	B	488.3	9	4.25**	0.67†	4.7	4.1	5.1	4.7	19.6	434
FRANKLIN MO. TAX-FREE INC. A	C	SL	C	411.8	15	4.25**	0.69†	5.0	3.9	5.3	4.8	21.4	233
FRANKLIN N.C. TAX-FREE INC. A	C	SL	B	377.6	15	4.25**	0.69†	4.9	3.9	5.3	4.9	19.1	333
FRANKLIN MA. TAX-FREE INC. A	B	SL	B	714.4	14	4.25**	0.67†	4.7	4.1	5.3	4.8	20.6	334
FRANKLIN N.Y. TAX-FREE INC. A	B+	MY	A	4603.3	7	4.25**	0.60†	4.7	4.2	5.7	5.1	19.5	223
FRANKLIN OH. INS. TAX-FREE INC. A	B	SL	B+	734.2	8	4.25**	0.65†	4.7	4.2	5.3	4.6	18.1	434
FRANKLIN OR. TAX-FREE INC. A	C	SL	C	500.6	14	4.25**	0.67†	4.2	3.6	4.9	4.8	20.6	444
FRANKLIN PA. TAX-FREE INC. A	C	SL	B	870.8	5	4.25**	0.67†	5.4	3.9	5.2	5.0	19.0	244
FRANKLIN VA. TAX-FREE INC. A	C	SL	C	388.0	14	4.25**	0.70†	4.4	3.5	5.0	4.9	21.8	334
JOHN HANCOCK TAX-FREE BOND A	D	ML	C-	536.8	4	4.50**	0.86†	2.5	3.0	4.8	5.1	19.2	244
HAWAIIAN TAX-FREE A	C	SL	C	620.2	8	4.00**	0.74†	4.5	3.8	5.0	4.5	14.4	433
LIBERTY TAX-EXEMPT A	F	ML	D	1951.8	6	4.75**	1.00†	3.2	2.8	4.9	4.9	17.8	223
LIMITED TERM TAX-EXEMPT BOND OF AMER. A	B+	MI	B	370.8	42	3.75**	0.75†	5.2	4.0	4.9	3.9	9.1	442
LORD ABBETT NATL. TAX-FREE INC. A	D	ML	C-	511.2	4	3.25**	1.01†	4.2	3.4	5.3	4.8	22.0	123
M.S. CA. TAX-FREE INC. B (b)	C	MC	B	707.2	-1	0.00**	0.93†	3.6	3.7	4.9	4.4	19.4	434
M.S. TAX-EXEMPT SECS. D (c)	B	ML	B+	1216.8	45	No load	0.51	4.3	4.2	5.5	5.2	17.8	334
MFS MUNICIPAL BOND A	D	ML	C-	1263.5	3	4.75**	0.59	4.2	4.0	5.1	4.9	15.3	334
MFS MUNICIPAL HIGH-INCOME A	C	MH	C	1044.4	8	4.75**	0.76	5.9	3.1	4.7	5.9	20.3	334
J.P. MORGAN TAX AWARE ENHANCED INC. INSTL. (d)		ML		1133.0	258	No load	0.50	4.0	NA	NA	3.1	13.0	
MPAM NATL. INTERM. MUNI. BOND MPAM (e)		ML		485.5	20	No load	0.52	5.0	NA	NA	4.3	12.7	
MPAM PA. INTERM. MUNI. BOND MPAM (f)		SL		863.9	-2	No load	0.67	4.7	NA	NA	4.2	10.2	
MUNICIPAL FUND INVEST. ACCUM. PROG.	F	ML	F	414.3	-2	No load	0.79	2.9	2.1	3.8	5.1	NA	333
NORTHERN INTERM. TAX-EXEMPT	B	MI	C	700.4	6	No load	0.85	4.9	3.9	4.5	3.9	10.9	542
NORTHERN TAX-EXEMPT	C	ML	B	545.1	4	No load	0.85	4.7	4.1	5.3	4.5	17.3	334
NUVEEN FLAGSHIP KY. MUNI. BD. A	C	SL	B	409.1	3	4.20**	0.85†	4.8	3.5	4.9	4.8	18.9	244
NUVEEN FLAGSHIP LTD.-TERM MUNI. BD. A	B+	MI	B	387.9	9	2.50**	0.76†	5.4	3.7	4.6	4.5	5.4	542
NUVEEN INSURED MUNI. BOND R	B+	ML	B+	659.9	4	No load	0.82	4.7	3.9	5.3	5.2	18.2	334
NUVEEN INT.-DUR. MUNICIPAL BOND R	B+	ML	A	2562.5	2	No load	0.58	5.0	4.0	5.5	5.1	14.4	234
ONE GROUP TAX-FREE BOND I	B	ML	B+	555.5	-5	No load	0.58	4.4	4.2	5.5	4.8	15.2	234
OPPENHEIMER CA. MUNICIPAL A	F	MC	F	399.5	44	4.75**	0.88†	3.7	3.0	4.9	4.9	17.4	233
OPPENHEIMER MUNICIPAL BOND A	F	ML	F	572.5	20	4.75**	0.85†	2.4	1.6	4.0	5.2	16.0	133
OPPENHEIMER N.Y. MUNICIPAL A	C-	MY	C-	527.4	3	4.75**	0.84†	4.5	3.6	5.1	5.0	18.9	233
OPPENHEIMER ROCHESTER LTD. N.Y. MUNI. A	A	MN	B	1113.5	21	3.50**	0.78†	4.8	3.8	5.0	4.6	18.9	433
OPPENHEIMER ROCHESTER MUNICIPALS A	C	MY	C	4137.9	20	4.75**	0.85†	5.1	3.6	5.5	5.7	12.5	123
T. ROWE PRICE MD. TAX-FREE BOND	B+	SL	A	1199.7	14	No load	0.49	5.0	4.2	5.5	4.9	16.5	334
T. ROWE PRICE TAX-FREE HIGH-YIELD	C	MH	C	1119.4	4	No load	0.72	4.7	2.4	4.5	5.8	17.9	143
T. ROWE PRICE TAX-FREE INCOME	B	ML	B+	1448.2	7	No load	0.54	4.4	4.0	5.5	5.0	16.4	234
T. ROWE PRICE TAX-FREE SHORT INTERM.	A	MI	A	442.6	10	No load	0.53	5.8	4.5	4.8	4.0	3.7	542
T. ROWE PRICE VA. TAX-FREE BOND	B	SL	B+	354.6	20	No load	0.54	4.9	4.3	5.6	4.8	15.8	234
PRUDENTIAL MUNI. BOND HIGH-INCOME A	C-	MH	C	526.6	-4	3.00	0.59†	4.3	1.6	4.1	5.3	19.3	144
PRUDENTIAL NATIONAL MUNICIPALS A	C-	ML	C	600.6	25	3.00	0.63†	4.0	3.7	5.2	4.8	17.9	244
PUTNAM CA. TAX-EXEMPT INCOME A	D	MC	D	2643.3	4	4.75**	0.75†	3.5	3.7	4.9	4.3	NA	343
PUTNAM MUNICIPAL INCOME A	C-	ML	C	841.9	21	4.75**	0.95†	4.4	3.2	4.9	5.2	19.5	244
PUTNAM NEW YORK TAX-EXEMPT INCOME A	D	MY	D	1362.2	7	4.75**	0.82†	3.2	3.8	5.1	4.3	NA	344
PUTNAM TAX-EXEMPT INCOME A	C-	ML	C	1684.1	6	4.75**	0.80†	3.9	3.4	4.9	4.9	NA	234
PUTNAM TAX-FREE HIGH-YIELD A	C-	MH	C	1129.2	0	4.75**	0.88†	3.9	2.0	4.0	5.9	NA	244
SAFECO MUNICIPAL BOND	C-	ML	C	546.2	12	No load	0.62	5.3	4.1	5.8	4.9	22.5	123
SCUDDER CA. TAX-FREE INCOME A (g)	D	MC	D	727.8	-3	4.50**	0.84	2.8	3.8	5.2	4.5	14.9	334
SCUDDER HIGH-YIELD TAX-FREE S	B+	MH	A	537.6	17	No load	0.79	5.2	3.9	6.0	5.4	18.2	123
SCUDDER MA. TAX-FREE S	B	SI	C	487.4	5	No load	0.75	4.2	4.1	5.4	4.8	8.3	333
SCUDDER MANAGED MUNICIPAL BOND S	B	ML	B+	822.8	7	No load	0.65	4.2	4.3	5.6	4.8	12.8	233
SCUDDER MEDIUM-TERM TAX-FREE S	B+	MI	C	580.2	-2	No load	0.72	4.6	3.9	5.0	4.4	7.4	443
SEI INTERM.-TERM MUNI. A	B+	MI	B	931.7	7	No load	0.60	4.7	4.1	5.1	4.1	9.9	442
SIT TAX-FREE INCOME	B+	ML	A	448.5	-9	No load	0.74	5.8	3.2	5.1	5.0	17.3	224
SMITH BARNEY CA. MUNICIPALS A	D	MC	C-	697.2	7	4.00**	0.68†	4.6	4.2	5.8	4.5	20.3	143
SMITH BARNEY MANAGED MUNICIPALS A	F	ML	F	2053.7	6	4.00**	0.68†	3.7	3.6	5.2	4.8	22.7	133
SMITH BARNEY MUNI. HIGH-INCOME A	D	MH	D	377.7	18	4.00**	0.82†	4.0	1.6	4.0	6.3	24.1	243
SMITH BARNEY MUNI. NATIONAL A	D	ML	C-	429.0	16	4.00**	0.68†	4.2	3.7	5.4	5.3	23.5	133
SMITH BARNEY N.Y. MUNICIPALS A	C-	MY	C	637.7	27	4.00**	0.69†	3.8	3.8	5.5	4.8	22.1	133
STATE FARM MUNICIPAL BOND	B+	MI	B	387.8	10	No load	0.15	5.1	4.6	5.4	4.9	6.1	433
STEINROE MANAGED MUNICIPALS	C	ML	C	455.1	0	No load	0.74	3.8	4.1	5.4	5.2	15.5	244
STRONG MUNICIPAL ADVANTAGE INV.	A	MS	B	1279.7	9	No load	0.60	3.1	3.3	3.9	3.9	0.9	533

*Includes redemption fee. **Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available.

(b) Formerly Morgan Stanley Dean Witter CA. T/F In/B. (c) Formerly Morgan Stanley Dean Witter Tax-Exempt Sec./D. (d) Formerly J.P. Morgan Tax Aware Enhanced Inc. (e) Formerly M National Intermediate Muni. Bond Fund. (f) Formerly MPAM PA. Intermediate Muni. Bond Fund. (g) Formerly Kemper CA. Tax-Free Income Fund/A.

Data: Standard & F

TUAL FUND SCOREBOARD

Bond Funds

	RATING (COMPARES RISK-ADJUSTED PERFORMANCE OF EACH FUND AGAINST ALL FUNDS)	CATEGORY (RATING COMPARES FUND WITHIN CATEGORY)	RATING	SIZE ASSETS \$ MIL.	% CHG. 2000-2001	FEES SALES CHARGE (%)	EXPENSE RATIO (%)	PERFORMANCE TOTAL RETURN (%)			PORTFOLIO		HISTORY RESULTS VS. ALL FUNDS
								1 YR.	3 YR.	5 YR.	YIELD (%)	MATURITY (YEARS)	
VANGUARD SHORT-TERM MUNICIPAL BD. INV.	A	MS	B	521.2	62	No load	0.60	5.2	3.8	4.8	4.4	3.0	54253
VANGUARD TAX-EXEMPT BOND OF AMERICA A	B	ML	B+	2260.2	22	3.75**	0.66†	5.6	4.2	5.5	4.7	15.0	23332
VANGUARD TAX-EXEMPT FUND OF CA. A	B	MC	B+	480.4	18	3.75**	0.69†	3.8	4.2	5.5	4.3	15.1	33324
VANGUARD TRUST OF AZ. A	B	SL	B+	403.7	11	4.00**	0.71†	4.7	3.8	5.1	4.6	12.9	34333
VANGUARD LIMITED-TERM MUNI. NATL. A	A	MI	B+	687.5	5	1.50**	0.99†	4.8	4.0	4.4	4.1	8.3	55243
VANGUARD TAX-EXEMPT CALIFORNIA BOND	C	MC	B	678.9	8	No load	0.39	3.3	3.8	5.7	5.0	20.0	12515
VANGUARD TAX-EXEMPT INTERMEDIATE TERM	A	MI	B+	2422.1	11	No load	0.36	5.5	4.2	5.6	5.2	8.9	22332
VANGUARD TAX-EXEMPT LONG TERM	C	ML	B	2107.9	5	No load	0.36	4.3	3.6	5.4	5.5	18.5	13514
VANGUARD TAX-EXEMPT SHORT TERM	A	MS	A	1146.4	15	No load	0.38	5.1	4.2	4.7	4.1	2.5	54153
VANGUARD TAX-EXEMPT VA. BOND	B	SL	B+	463.4	15	No load	0.43	4.3	4.0	5.5	5.1	18.3	23514
VANGUARD HIGH-YIELD MUNI. A	B+	MH	B+	1280.7	29	4.75**	0.91†	5.0	2.7	5.1	6.0	21.9	12353
VANGUARD INSURED TAX-FREE INCOME A	F	ML	D	1148.7	6	4.75**	0.90†	3.5	3.6	4.9	4.1	17.4	43515
VANGUARD MUNICIPAL INCOME A	F	ML	D	686.0	0	4.75**	0.83†	3.8	2.0	4.0	4.8	16.1	34544
VANGUARD TAX-FREE HIGH-INCOME A	D	MH	D	596.6	-3	4.75**	0.87†	4.4	1.2	3.7	5.4	20.5	33454
VANGUARD CA. INS. INT.-TERM TAX-EXEMPT	A	MF	B	1645.6	-3	No load	0.17	4.4	4.8	5.6	4.5	7.1	43224
VANGUARD CA. INS. TAX-FREE L-T TAX-EXEMPT	B	MC	B+	1588.7	-9	No load	0.18	3.4	4.9	6.0	4.9	NA	32415
VANGUARD FL. INS. LONG-TERM TAX-EXEMPT	B	SL	B+	835.4	-9	No load	0.15	4.5	4.8	6.0	4.8	10.8	32413
VANGUARD INTERM.-TERM TAX-EXEMPT	B+	MI	B	6756.0	-22	No load	0.18	5.1	4.5	5.3	4.8	5.8	43233
VANGUARD MUNI. BOND HIGH-YIELD	B	MI	C	2822.2	-8	No load	0.19	5.3	4.1	5.6	5.5	10.1	22423
VANGUARD MUNI. BOND INS. LONG-TERM	B	ML	B+	1881.6	-19	No load	0.19	4.3	4.8	5.8	5.0	9.6	33414
VANGUARD MUNI. BOND LIMITED-TERM	A	MI	A	2103.1	-26	No load	0.18	5.6	4.4	4.7	4.3	3.1	54252
VANGUARD MUNI. BOND LONG-TERM	B	ML	B+	1224.5	-27	No load	0.19	4.7	4.6	5.8	5.2	9.9	23413
VANGUARD N.J. INS. LONG TAX-EXEMPT	B+	SL	A	953.7	-23	No load	0.19	4.6	4.7	5.8	4.9	9.4	32313
VANGUARD N.Y. INS. LONG TAX-EXEMPT	B	MY	B+	1332.6	-20	No load	0.20	4.1	4.6	5.8	4.7	9.3	32414
VANGUARD OH. LONG-TERM TAX-EXEMPT (h)	B	SL	B+	484.1	21	No load	0.19	4.6	4.6	5.7	4.9	8.6	33413
VANGUARD PA. INS. LONG TAX-EXEMPT	B+	SL	A	1543.3	-20	No load	0.19	4.8	4.8	5.7	5.1	9.9	43313
VANGUARD SHORT-TERM TAX-EXEMPT	A	MS	B+	1322.2	-37	No load	0.18	4.7	4.1	4.1	3.9	1.3	55153
VANGUARD & REED ADV. MUNI. BOND A	F	ML	D	745.8	2	4.25	0.88†	1.9	1.9	4.2	4.5	9.1	14535
VANGUARD & REED ADV. MUNI. HIGH-INC. A	C	MH	C	420.3	2	4.25	1.02†	5.2	1.7	4.6	5.3	10.0	12553
VANGUARD FARGO CA. TAX-FREE A	C	MC	B	385.6	2	4.50**	0.77	4.2	4.5	5.9	4.6	20.1	22414

† Includes redemption fee. ** Includes deferred sales charge. †12(b)-1 plan in effect. NA=Not available.

Source: Morningstar. Vanguard Ohio Insured Long-Term Tax-Exempt Fd.

Data: Standard & Poor's

Telephone numbers

INDS
 4246
ICE FUNDS
 5672
ICE MUNI FUNDS
 5672
AN CENTURY FUNDS
 2021
AN FUNDS
 0180
A FUNDS
 3863
INDS
 7919
SPECIAL TAX-EXEMPT FUNDS
 7919
TEIN FUNDS
 5672
RT FUNDS
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TT TAX-FREE FUNDS
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SIA FUNDS
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ICE FUNDS
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A COX FUNDS
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IS FUNDS
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IS GENERAL FUNDS
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A new periodic series will guide you through accounting iss

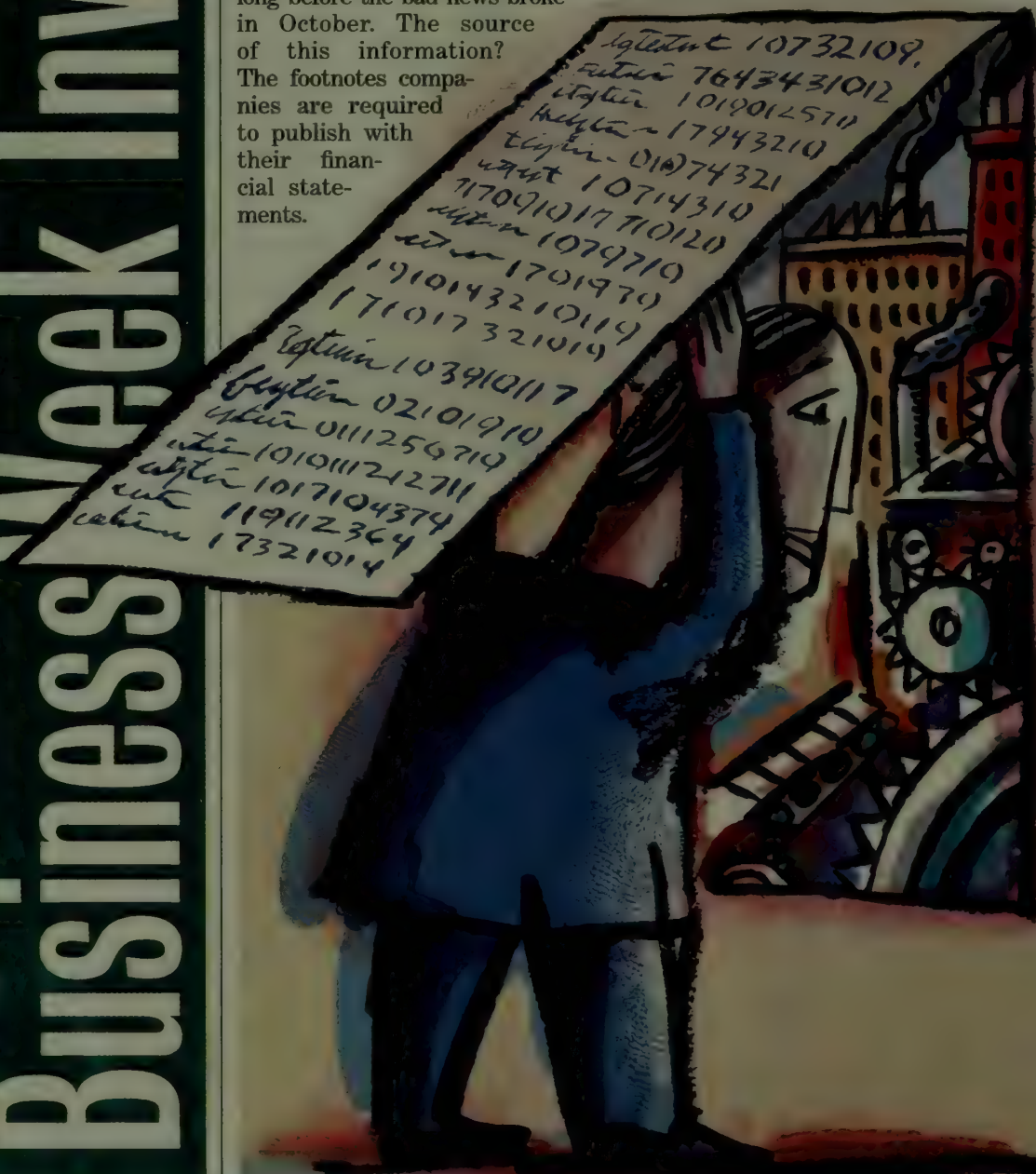
Buried in Enron's annual report for 2001, for example, are hints of the hidden debt that pushed the company into bankruptcy in December. A footnote on "preferred stock" states that if Enron's share price were to fall below \$48.55—which first occurred on Dec. 14—the company would be obliged to convert the stock to a partnership called Whitewing Capital. Other footnotes reveal similar arrangements.

ments. True, never put a dollar on its potential conditions, and the foot did not divulge the content of the partnerships. But enough revealed to show that investors were getting a full view of the company's financial

As Enron's collapse illustrates, it is worth a look behind the numbers of the companies releasing quarterly and annual financial statements. That's why *Business Week* Investor is launching The Fine Print series in which we will periodically examine various sorts of notes you'll find in company reports.

Footnotes often list items that can greatly affect the bottom line yet are invisible on the balance sheet, the income statement or the cash-flow statement. That's because accountants often combine several items in a catch-all category such as "other income" or "other assets."

Take IBM. No
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ion, or 7% of pretax income. the pension fund's contribution is spelled out in a footnote. Combined with a section of the annual report called "management's discussion and analysis," the footnotes "give some powerful information at the story behind the numbers," says Lynn Turner, director of the Center for Quality Financial Reporting at Colorado State University. "If done right, footnotes will also give some good predictive information with respect to where the company is headed," adds.

Footnotes do not make for easy reading, however, and numbers are often difficult to decipher. In addition, there can be a long lag between the publication of earnings and the clarifying footnotes. Why? While companies usually disclose earnings in press release shortly after the end of each quarter, they take up to 45 days to file quarterly 10-Qs and up to 90 days to release the annual 10-Ks that contain footnotes.

There's no cookie-cutter method to extract what's important from the fine print. The footnotes devoted to transactions with related parties are important at Enron, for example, but it's not relevant to every company. And you can't assume that one footnote contains all a company has to say about a topic. To investigate off-balance-sheet financing, for example, you must often read several footnotes, including those that detail topics such as related party transactions, minority interests, and unconsolidated affiliates. "You

to interrelate things," says Bob Olstein, portmanager of the Olstein Financial Alert Fund. Finally, if after reading a set of footnotes you're more confused than enlightened, steer clear of stock. As Enron's fall illustrates, companies

Pension Footnotes: What to Look for

Pension income often affects a company's bottom line. We show how, using the pension footnote from Qwest Communications International's 2000 annual report

(dollars in millions)	Pension Cost			Post-retirement Benefit Cost		
	Year Ended December 31,			Year Ended December 31,		
	2000	1999	1998	2000	1999	1998
Service cost	\$ 182	\$ 203	\$ 189	\$ 49	\$ 70	\$ 72
Interest cost	702	658	639	337	326	319
Expected return on plan assets	(1,098)	(935)	(852)	(271)	(229)	(213)
Amortization of transition asset	(79)	(79)	(79)	—	—	—
Amortization of prior service cost	2	2	2	12	20	19
Plan curtailment	—	—	—	(106)	—	—
Recognized net actuarial gain	(58)	—	—	(107)	(28)	(30)
Net (credit) cost	\$ (319)	\$ (151)	\$ (101)	\$ (86)	\$ 159	\$ 167

	Pension			Post-retirement Benefit		
	Year Ended December 31,			Year Ended December 31,		
	2000	1999	1998	2000	1999	1998
Weighted average discount rate	8.00%	6.75%	7.00%	8.00%	6.75%	7.00%
Weighted average rate of compensation increase	4.65%	4.65%	5.50%	N/A	N/A	N/A
Expected long-term rate of return on plan assets	9.40%	8.80%	8.50%	9.40%	8.80%	8.50%

that aren't straightforward risk seeing investor confidence evaporate at the first sign of trouble.

We are inaugurating The Fine Print series by examining the footnote for pension accounting. This footnote is key because, during the bull market, income from defined-benefit pension plans became a significant source of profits for many companies. Indeed, pretax earnings were lifted by an average of 12% at the nearly one-third of the companies in the Standard & Poor's 500-stock index that reported pension income in fiscal 2000, says Jane Adams, a pension analyst at Credit Suisse First Boston. Of course, if stock market losses persist, this trend will reverse—with falling pension assets eroding many corporate bottom lines.

When a company promises to pay pension benefits to retirees, it takes on an obligation, or liability. Attaching a figure to that obligation is an inexact science that involves estimating employees' longevity and future salary levels, among other

TABLE 1

Qwest's pension plan contributed \$319 million to its bottom line in 2000. The company also increased the projected return on its pension plan to 9.4%, from 8.8% in 1999.



THE FINE PRINT

(dollars in millions)	Pension		Post-retirement Benefit	
	Year Ended December 31,		Year Ended December 31,	
	2000	1999	2000	1999
Fair value of plan assets at beginning of year	\$14,593	\$12,925	\$2,886	\$2,604
Actual return on plan assets	(78)	2,509	(68)	575
Net employer withdrawals	—	—	(245)	(212)
Contributions	—	(8)	—	(1)
Section 402 transfer	(90)	(111)	90	111
Benefits paid	(831)	(722)	(256)	(191)
Fair value of plan assets at year end	\$13,594	\$14,593	\$2,407	\$2,886

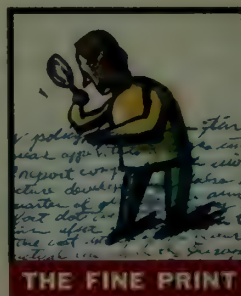
TABLE 2

Even though Qwest booked income from its pension plan, the plan actually lost \$78 million in 2000. That helped to reduce the plan's value to \$13.6 billion.

things. To convert the pension obligation from future dollars to a current value, accountants "discount" it at an interest rate that assumes the company will settle its obligation by investing in high-quality bonds.

This number isn't on the balance sheet. Instead, it is offset by the value of the pension plan's investments, adjusted to smooth out some stock market volatility. Depending on whether the plan's obligation or adjusted value is greater, the company records a net pension asset or liability.

To find the pension plan's impact on net income, check the pension footnote in the annual report. For Denver-based Qwest Communications International, the note shows that the plan produced a "net credit"—or addition—to income of \$319 million in 2000 (Table 1). Despite this, Qwest lost \$81 million that year.



Qwest may build up deferred losses to the point where accounting rules require the company to put some ink on the income statement.

Partially offsetting the \$1.068 billion gain generated by "expected return on plan assets" are two expenses itemized in Table 1, service cost and interest cost. Service cost represents pension benefits employees earned during 2000. Interest cost is the ar-

interest cost on the pension obligation—a figure analogous to interest payments on debt.

Check the lower half of Table 1. There you find the "weighted average discount rate" used to figure the current value of these expenses as well as the overall pension liability. When the rate—pegged to interest rates—falls, the pension obligation rises, says Janet Pegg, a Bear Stearnes accounting analyst.

The footnote also indicates if a pension fund

is over- or underfunded, thus potentially in need of cash infusions. In Qwest's case, the news is good. At the end of 2000, its pension plan was worth \$13.6 billion (Table 2). That exceeded the \$9.5 billion (Table 3) it promised to deliver in pension benefits over the next 20 years (\$4.1 billion. (This number appears under "funded status" in Table 4.) Because Qwest's pension fund is amply overfunded, the footnote shows the company's contribution to the plan in 2000.

The days of fat pension gains may be over for Qwest. In part because the plan's actual return for 2000 was negative, the deferred gains—technically called "unrecognized actuarial gains"—stockpiled during the bull market from \$4.6 billion to \$2.9 billion (Table 4).

Deferred gains can be used when actual returns exceed expected returns. Such gains

are put into a pot, along with gains and losses on other pension items, such as changes in assumptions about future salaries. If the pot becomes big enough, some of it is required to spill over into net income. In 2000, Qwest recognized \$58 million (Table 1) of its deferred gains—technically called "net actuarial gains." But with deferred gains dwindling, less will be available to boost the bottom line in the future, says Pegg. More troubling, some, if the plan's assets continue to shrink, could erase the expected returns that nearly erased Qwest's red ink in 2000.

It's a good bet that Qwest is not alone. Check the footnotes in those financial statements and find out whether an ugly surprise may be lurking in the form of fading pension income.

TABLE 3

Qwest owed its employees and retirees \$9.5 billion at the end of 2000, up from \$8.9 billion in 1999. Still the plan was overfunded, because it had \$13.5 billion in assets.

	Pension Cost		Post-retirement Benefit Cost	
	Year Ended December 31,		Year Ended December 31,	
(dollars in millions)	2000	1999	2000	1999
Benefit obligation at beginning of year	\$6,877	\$6,822	\$4,344	\$4,825
Service cost	182	203	49	70
Interest cost	702	658	337	326
Actuarial loss (gain)	513	(584)	301	(690)
Plan amendments	—	—	(160)	—
Special termination benefits	27	—	—	—
Plan curtailment	—	—	(106)	—
Benefits paid	(831)	(722)	(256)	(191)
Benefit obligation at end of year	\$6,470	\$6,877	\$4,500	\$4,344

	Pension		Post-retirement Benefit	
	Year Ended December 31,		Year Ended December 31,	
(dollars in millions)	2000	1999	2000	1999
Funded (unfunded) status	\$ 4,124	\$ 5,716	\$(2,093)	\$(1,456)
Unrecognized net actuarial gain	(2,923)	(4,840)	(730)	(1,479)
Unamortized prior service (benefit) cost	—	2	(58)	125
Balance of unrecognized transition asset	(308)	(387)	—	—
Prepaid (accrued) benefit cost	\$ 894	\$ 691	\$(2,881)	\$(2,812)

TABLE 4

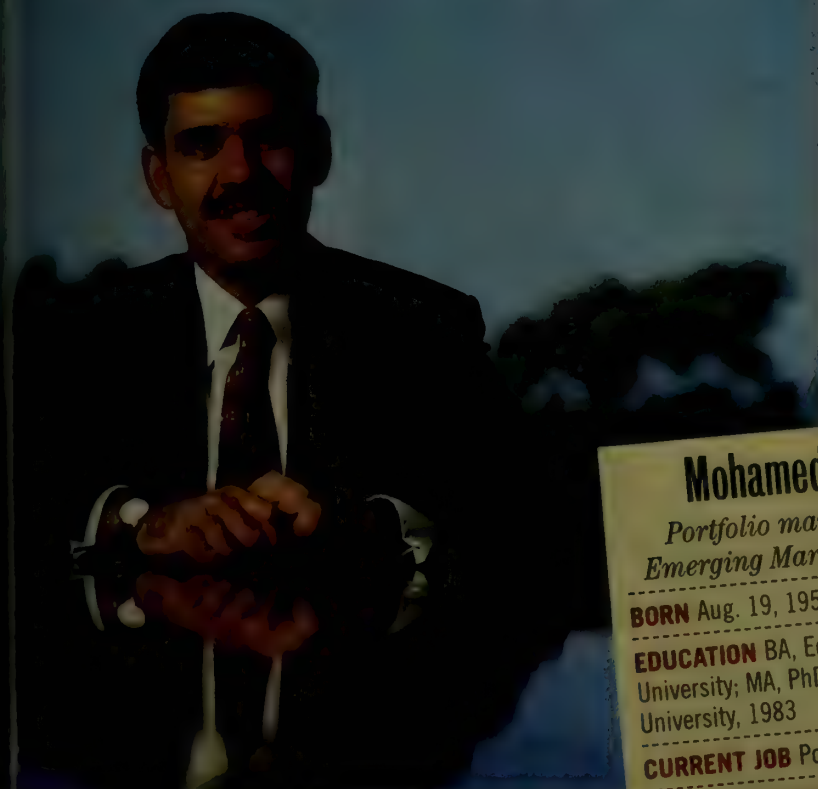
Qwest records a net pension asset of \$894 million on its balance sheet. The table also shows unrecognized gains, a source of corporate profits in the past. This declined from \$4.6 billion in 1999 to \$2.9 billion in 2000.

The same table reveals that the biggest contributor to Qwest's pension windfall was \$1.068 billion generated by its "expected return on plan assets." Accounting rules permit the use of an expected return because relying on a day-to-day return would cause net income to jump around with the stock market. The bottom half of this table shows that Qwest expects its plan assets to gain 9.4% a year, on average. It increased that rate from an 8.8% projection in 1999. Given the stock market's doldrums, it's a good bet Qwest didn't meet that goal in 2001.

In contrast to Qwest's \$1.068 billion expected return, its actual return was a \$78 million loss in 2000, following a \$2.5 billion gain in 1999 (Table 2). If real returns continue to trail expected returns,

Many Worlds to Watch

tireless approach has El-Erian leading the pack



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trader has
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If Mohamed El-Erian were any busier, he wouldn't get any sleep. The 43-year-old portfolio manager of PIMCO Emerging Markets Bond Fund wakes up at 3:15 every morning to walk his boxer pup, Ché. That's also when he calls PIMCO's London office to check on the 17 markets he tracks. By 4:30 a.m., he is at his Newport Beach (Calif.) office, writing a summary of the night's events for PIMCO's 200-member debt analysis team. With their feedback, he starts trading at 6 a.m., continuing nonstop till 4 p.m.

Such diligence would have been pointless a few years ago when emerging markets moved in tandem. If Chinese bonds fell, Mexican ones would too, even if Mexico's economy was fine. But the past three years have seen a "decoupling" of emerging markets, so investors now see them as separate entities. After the Russian debt crisis of 1998, the International Monetary Fund began publishing detailed credit reports on each market, and countries realized the importance of communicating with creditors. "With more access to information and analysis, investors can differentiate better between countries," says El-Erian. That's a skill he honed in the 14 years he worked at the IMF where "you get to see how policymakers in these countries think and

what measures are at their disposal." El-Erian is a New York-born economist who attended Oxford and Cambridge on scholarship.

The decoupling trend was sharply evident in 2001. Argentine bonds, which had a 22% weighting in the J.P. Morgan Emerging Market Bond Index, plummeted 66.9%, yet the 16 other emerging markets that the index tracks all rose—from a 5.5% gain for Venezuela to 55.8% in Russia.

The wide variations allowed El-Erian, who actively shifts between countries, to stand out. His fund rose 27.6% in 2001, more than double the average emerging-market bond fund's 10.6% total return. And its 25.8% three-year annualized return (as of Jan. 21) beats any other retail bond fund. Besides the \$135 million fund, he runs \$6.4 billion for institutional clients. Lately, he's been buying Panama's bonds, which he sees as relatively safe and cheap, and selling Russia's, which may be vulnerable to a decline in oil prices.

El-Erian sees emerging markets in three tiers.

First-tier countries, such as Mexico and Poland, have learned from the currency crises of the 1990s. Anchored economically to more industrialized partners, such as the U.S. and Germany, they've improved their balance sheets and raised their foreign currency reserves. El-Erian invests most of his portfolio in this tier. The bonds tend to have higher credit ratings and lower yields than those of other markets. Mexican sovereigns, for instance, yield 7.5% and are rated BBB, vs. the 11.5% yield and BB- rating for the benchmark. "Mexico has accumulated significant international currency reserves, and it has pre-financed its debt for 2002," he says.

At the other end of the spectrum are third-tier markets such as Argentina, which in January defaulted on its debt. El-Erian anticipated that 18 months ago and sold the bonds. "Argentina established a currency pegged to the U.S. dollar without the willingness to accept the discipline that comes with that," he says. Others in the tier include Ukraine and Ecuador, whose bonds now yield 14% and 16%, respectively.

Between the first and third tiers are such nations as Brazil and the Philippines. Their bonds have high yields but are less volatile than the third tiers. Brazilian sovereigns, for instance, yield over 13% because of fears of contagion from Argentina, Brazil's biggest trading partner. El-Erian thinks these worries are largely unfounded, so he holds a 25% Brazil position, a neutral weighting relative to his benchmark. Yet he realizes that conditions could change overnight. That's why he walks his dog hours before the sun comes up. ■

Mohamed El-Erian

Portfolio manager, PIMCO
Emerging Markets Bond Fund

BORN Aug. 19, 1958. New York, N.Y.

EDUCATION BA, Economics, Cambridge University; MA, PhD, Economics, Oxford University, 1983

CURRENT JOB Portfolio manager, PIMCO

PREVIOUS EXPERIENCE Deputy director, International Monetary Fund, 1983-97; managing director, economic research, Salomon Smith Barney, 1997-99

INVESTING APPROACH "Every morning, we ask ourselves if our views are consistent with the data coming out. We don't rely on what Wall Street tells us."

THE SISTERHOOD IN PRIVATE BANKING



BY TODDI GUTNER
hers@businessweek.com

When a source suggested I profile a top woman in private banking last year, I didn't think that was a strong enough story. But his repeated calls prompted me to do some research, and that led me to a startling discovery: Women head up no fewer than 10 of the biggest names in private banking and wealth management, including Merrill Lynch Trust, J.P. Morgan Private Bank, and Citigroup Asset Management. Collectively, they're responsible for more than \$1 trillion in personal investments and trusts. Even in the lower ranks, women comprise up to 40% of the professionals at many of these firms.

Once thought of as staid and boring compared with the more glamorous world of investment banking, the private banking and wealth management business has evolved into one of the hottest in financial services. That's reflected in its price-earnings multiple of 25, which is well above the 14 for investment banking and 16 for credit-card divisions, according to a J.P. Morgan analysis. The transformation has much to do with the industry's increased focus on generating recurring fees for managed assets and developing multigenerational relationships, both features of private banking and wealth management.

The arm of the banking business that used to service just the nation's wealthiest families has become more democratic in recent years. While you still need a minimum of \$25 million to open an account at J.P. Morgan, many more institutions are now welcoming clients with as little as \$500,000.

In trying to figure out why women have been so successful in this area, I interviewed 9 of the 10 executives on our list (table). While they all claimed they didn't think about gender

when it came to their career accomplishments, each said in different ways that the nature of private banking plays to women's strengths. "We have a clarity and appreciation for developing relationships," says Maribeth Rahe, president of U.S. Trust. Meister, chairwoman and CEO of Merrill Lynch Trust, agrees: "We love about the business the people aspect, because you're really connecting relating the work you do to how it impacts people's lives. Indeed, money management is more than achieving a desired rate of return. While significant technical skills are necessary, private bankers—sometimes called relationship managers—also need to help clients articulate their personal objectives and their wealth. To do that, you must quickly establish trust and rapport. Managers "must be

comfortable listening and ceding power to a client and not spending time showing what they know," says Heidi Schneider, head of private client services at Neuberger Berman, an investment manager and mutual fund company. Because women often come across as sensitive and empathetic, even many men would rather speak to a woman about personal wealth matters than to another man.

Wealth managers—not unlike working mothers—also require the ability to juggle tasks and orchestrate teams of people across various divisions. For instance, a client may need to set up a trust, offset a huge exposure in a single stock with derivatives, and invest the proceeds from the sale of a business. "In three seconds my mind goes from the sublime to the ridiculous," says Maria Elena Lagomasino, chairwoman of J.P. Morgan Private Bank, who might be recommending a dentist one minute and hashing out complex estate planning issues the next.

Finally, the field provides female executives with a reasonable work/life balance. Although trust clients can be demanding, they aren't likely to insist that you hop a plane at 4 p.m. on Sunday for a meeting. "It's a business where you can make a contribution, yet still have control and flexibility," says Wendy Murdoch, chief operating officer for retail and high-net-worth clients at Citigroup Asset Management. No wonder so many talented women have been drawn to the field.

A Sorority of Top Wealth Managers

NAME/ COMPANY	ASSETS UNDER COMPANY'S ACTIVE MANAGEMENT BILLIONS
MARIA ELENA LAGOMASINO J.P. Morgan Private Bank	\$300
DORIS MEISTER Merrill Lynch Trust	300
WENDY MURDOCK Citigroup Asset Management	240
MARIBETH RAHE U.S. Trust	93
KATHLEEN McGILLYCUDDY FleetBoston Private Client Bank	50
LESLIE BAINS HSBC U.S. private banking and wealth management	45
ANNE TATLOCK Fiduciary Trust	41
ALLISON WINTER Northern Trust Personal Financial Services Midwest	32
HEIDI SCHNEIDER Neuberger Berman private asset management	23
MAYREE CLARK Morgan Stanley global private wealth management	NA*

*NA=Not available

Data: BusinessWeek



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WHY PAYPAL MIGHT NOT PAY OFF



BY ROBERT BARKER

rb@businessweek.com

The Internet company has impressive cash flow, but it faces some big rivals. And it could run into trouble with state banking regulators. Will its IPO fly?

Is the coast clear for a fresh Internet IPO? A small but fast-growing Silicon Valley company called PayPal hopes so. With underwriters led by Salomon Smith Barney, PayPal is preparing an initial public offering of an estimated \$70 million in stock. After a year when the number of IPOs dropped to 80, from 385 in 2000, many eyes are on the deal, due any day now.

If most people have never heard of PayPal, it's because they aren't tempted by online auctioneer eBay and its featured items, such as the "Grand Funk Railroad Collector Series Sealed CD" I spied there the other day. Yet eBay denizens know PayPal well: It's their favorite way to exchange money online. After at least one in four eBay auctions, buyers settle up by clicking on a link to PayPal, which takes a small fee from the seller. Beyond eBay, PayPal also appeals to small online merchants. Revenues last year soared to \$105 million, from \$14 million in 2000. PayPal netted a loss of \$108 million. Yet, while full-year cash-flow results still are not in, through Sept. 30 operating cash flow swung to \$34 million from a prior-year burn of \$12 million—not, in other words, the sort of bubblicious Internet IPO that plagued us in 1999.

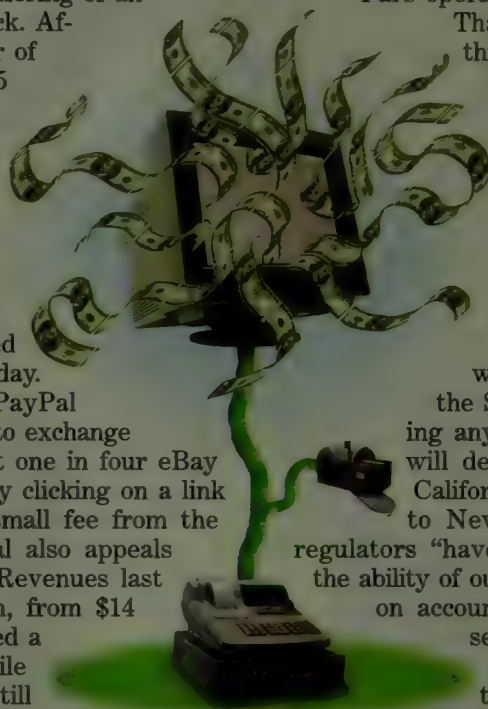
Before placing your bid, however, know that PayPal faces two sizable threats: competition and regulation. Execs at PayPal, which so far has been bankrolled by leading venture capitalists (table), declined to talk ahead of the deal. But their securities filing identifies two chief rivals: Citigroup, which runs a money exchange known as c2it, and eBay itself, with its own eBay Online Payments. Both have been slower than PayPal to win market share, yet each boasts formidable advantages. eBay can use its control of the online auction block to steer bidders toward its service—or ban PayPal altogether—while c2it is promoted prominently by America Online and Microsoft's MSN. Both enjoy the financial muscle of big banks, including Wells Fargo, which owns part of eBay's service. Their bank affiliations ease the way for eBay Online Payments

and c2it to set up their money-transfer service. PayPal's lack of ties to a bank, by contrast, could prove to be a problem. Its lengthy glazing user agreement says explicitly that it is not a bank, but to regulators in four states—California, New York, Idaho and Louisiana—PayPal looks suspiciously like an unlicensed banking operation. They are questioning PayPal's practice of opening accounts from which users can leave cash, have it swept into a PayPal money-market fund, or withdraw it via check and debit cards. They could conclude that PayPal's operation is illegal.

That's no slim chance. In three days after I raised the issue with the states—California, New York, Idaho and Louisiana—PayPal expedited its filing with the Securities & Exchange Commission. Its depiction of the regulatory risk is more sober. For example, PayPal's earlier filing, dated "New York regulatory waiting for a determination from the State of California before taking any action, but we believe we will defer to the conclusion of California authorities." Its reference to New York now says only that regulators "have expressed their view on the ability of our customers to leave an account for future transfer of funds."

In California, too, regulators are still trying to resolve PayPal's questionable status. Counterparts in Idaho and Louisiana told me that their regulators also remain very much open to the possibility of doing business with PayPal, but they do frown on anyone retreating from a customer," said Newport, general counsel of Louisiana's Office of Financial Institutions. "Until we have solved [our concerns], PayPal has been instructed that they may not do business in" Louisiana. PayPal hopes the Federal Deposit Insurance Corp. will issue an advisory opinion that PayPal accounts do not tread too close to banking. The FDIC told me it is still studying the question.

The regulatory clouds over PayPal's future—and stock—could blow away. But given how much experience with regulators PayPal's two leading rivals, Citigroup and Wells Fargo, have built up, a rather bid on a Grand Funk



Paying for PayPal

ON SALE
5.4 million shares, or 9% of equity
ESTIMATED PRICE
\$13 a share
TANGIBLE BOOK VALUE
\$1.11 a share
AVERAGE PRICE PAID BY EXISTING SHAREHOLDERS
\$3.79 a share
NOTABLE VENTURE- CAPITAL INVESTORS
Sequoia Capital (9.8%); Nokia Venture Partners (8.8%); Clearstone Venture Partners, formerly Idealab Capital Partners (6.3%)

Data: Company reports

BusinessWeek online

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or some companies, long term planning means an *annual plan*...
at Omron, we just finished our *decade plan*.

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sensing and control technologies toward the needs of
st century society. It's not a crystal ball, but a tool to
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The growing popularity of instant-ticket lotteries is sparking interest in Scientific Games (SGM). A global provider of instant tickets and services for lottery and pari-mutuel outfits, Scientific is still not on institutional investors' radar screens. Yet the stock was a knockout last year, soaring from 2 in April, 2001, to 5 in July—and to 8.18 by Jan. 23. The company, formerly Autotote, changed its name after it acquired Scientific Games two years ago. With Scientific's lottery knowhow and Autotote's tech skills, "the combined company has an impressive growth story," says Joyce Minor of Lehman Brothers, who rates the stock a strong buy. She sees Scientific turning profitable soon, earning 31¢ a share in 2002 and 37¢ in 2003. The estimates may be conservative, says Minor, if Scientific keeps winning contracts in the U.S. and overseas. It has won on five of seven bids it has made since the merger, including contracts in Vermont and South Carolina. Sales are expected to rise to \$481 million in 2002 and to \$492.5 million in 2003. Scientific has 68% of the U.S. lottery market, operating in 28 of the 39 jurisdictions where lottery is legal and in 61 foreign countries. And it supplies wagering systems at racetracks worldwide. CEO Lorne Weil says Web and phone bets in racetracks are rising fast.

But there is more than just earnings to Scientific's appeal: Some pros say Scientific is an enticing buyout: "Its niche position in lottery and pari-mutuel makes it a compelling target," says Robert Olstein of Olstein Financial Alert Fund, which manages \$1 billion. Publisher D'Agostini of Italy, where Scientific operates lotteries, is buying Olivetti's 30% stake in Scientific. Other sources say another company may buy a big stake. CEO Weil declined to comment on the buyout or stock purchase speculation.

STORAGE COMPUTER FIGHTS THE GOLIATHS

Tiny Storage Computer (SOS), a provider of data-storage systems, with 2001 sales of only \$9 million, is doing battle with the giants of the industry—companies such as Hitachi and Veritas Software. Storage has sued both for patent infringement. And Storage may take on even bigger foes, such as Hewlett-Packard, EMC, and IBM. Storage has been emboldened by its success with Seagate Technology, which settled in Decem-

ber on an infringement suit that Storage filed in March, 2001, against Seagate's Xitech unit. Storage said Xitech violated its patent on specific data-storage methods. Seagate agreed to pay \$2.5 million for licensed use of a Storage patent. "This first win brings huge pressure on other defendants, such as Hitachi, to settle," says John Faessel, publisher of *On the Market* newsletter.

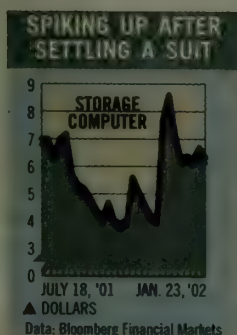
Storage is lining up more lawsuits, says Mike Kicera of McDonald Investments, an affiliate of multiregional bank KeyCorp., which has bought shares. A top Dallas law firm, Sidley Austin Brown & Wood, is handling Storage's lawsuits.

Seagate's settlement was based on a 5% royalty on patent-related sales, so Kicera figures the Hitachi case might mean a win of \$250 million—or \$13 a share. "That's significant for a small company like Storage," says Kicera, who believes Hitachi and Storage are in talks for a settlement. Storage, now at 6.31 a share, could run up to 25 in 18 months, says Kicera—taking into account a Hitachi settlement, which he expects. Storage CEO Theodore Goodlander declines comment on the lawsuits. Hitachi couldn't be reached.

WINDFALL AHEAD AT LENDINGTREE?

Hedge-fund manager Jonathan Cohen of JHC Capital Management thinks tech buyouts will proliferate this year. For one thing, the big-cap techs are rebounding—and scouting for fields to diversify into, to offset a weakening in their core businesses. And the low-cap techs, including the neglected Internet stocks, are getting more attractively valued as they move toward profitability.

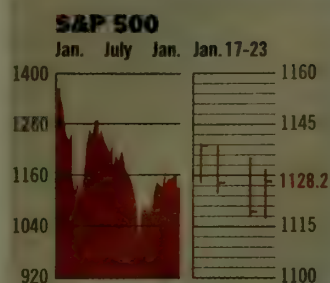
LendingTree (TREE) is one that is takeover bait, says Cohen, for the likes of Yahoo! or eBay. LendingTree brings borrowers and lenders together through its Web site. It gives borrowers access to a network of brokers and banks that best fit their needs. And it provides lending firms with technology to automate their sites for instant services, such as mortgage and equity loans. LendingTree takes no risk in the process. It closed 210,000 loans worth \$8 billion in the first nine months of 2001, up 150% from a year ago. Sales jumped 114%, to \$45 million. Its stock has been rising since Sept. 21, when it had fallen to 3.98, from 6.52 in July. It is now at 7.87. Cohen sees LendingTree in the black in 2002, earning 33¢ a share. He expects the stock will climb to 15 to 20 in 18 months.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:30 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

A spate of weak earnings reports, coupled with the ongoing Enron scandal, rained down on the markets, sending investors scurrying for cover. Then on Jan. 23, Merrill Lynch, the nation's largest brokerage, reported a record \$1.3 billion loss in the quarter ended Dec. 31. Buyers, however, emerged that day, on the hope that the worst may be over for equities.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Jan. 23	Week	Year to date	Last 12 months
S&P 500	1128.2	-1.6	-1.7	-17.1
Dow Jones Industrials	9731.0	-1.9	-2.9	-8.6
Nasdaq Composite	1922.4	-3.9	-1.4	-32.3
S&P MidCap 400	501.4	1.1	-1.3	-3.6
S&P SmallCap 600	228.7	-0.8	-1.5	1.1
Wilshire 5000	10,522.1	-1.5	-1.7	-16.4

SECTORS

	Jan. 23	Week	Year to date	Last 12 months
BusinessWeek 50*	710.0	-0.5	-2.7	-32.3
BusinessWeek Info Tech 100**	405.0	-2.2	-3.4	-39.9
S&P/BARRA Growth	589.3	-1.5	-0.9	-17.1
S&P/BARRA Value	537.9	-1.7	-2.6	-17.6
S&P Energy	205.0	-0.9	-3.0	-9.8
S&P Financials	354.9	-0.7	-0.1	-9.1
S&P REIT	93.3	-0.6	-0.1	6.3
S&P Transportation	202.6	3.3	2.9	1.5
S&P Utilities	140.1	-3.1	-3.9	-27.1
GSTI Internet	100.8	-4.2	-3.9	-56.0
PSE Technology	676.2	-3.2	-1.6	-27.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Health-Care Supplies	13.8	48.9
Internet Software	9.0	41.2
Specialty Appar. Retailers	8.2	40.0
Restaurants	8.1	39.5
Tobacco	7.9	33.3

EQUITY FUND CATEGORIES

	4-week total return %	52-week total return %
Leaders		
Precious Metals	8.9	30.0
Diversified Emerging Mkts.	5.5	9.8
Pacific/Asia ex-Japan	4.7	9.1
Financial	1.1	2.6
Laggards		
Communications	-6.1	-47.6
Health	-5.7	-45.3
Natural Resources	-5.1	-33.8
Mid-cap Growth	-3.8	-26.6

EQUITY FUNDS

	4-week total return %	52-week total return %
Leaders		
American Heritage	62.5	113.6
Pilgrim Russia A	16.9	73.2
Frontier Equity	13.4	69.0
Vontobel Eastern Europ. Eq.	12.9	67.8
Laggards		
World GenomicsFund.com	-24.7	-78.4
Amerindo Hlth. & Biotech. D	-20.3	-77.0
Fidelity Select Wireless	-17.6	-76.6
Rydex BioTechnology Inv.	-13.1	-75.4

Data: Standard & Poor's

GLOBAL MARKETS

	Jan. 23	Week
S&P Euro Plus (U.S. Dollar)	1032.4	0.8
London (FT-SE 100)	5180.6	1.0
Paris (CAC 40)	4450.8	0.6
Frankfurt (DAX)	5163.0	3.6
Tokyo (NIKKEI 225)	10,040.9	-1.3
Hong Kong (Hang Seng)	10,762.1	-1.8
Toronto (TSE 300)	7598.5	0.2
Mexico City (IPC)	5782.8	3.1

FUNDAMENTALS

	Jan. 22	Wk
S&P 500 Dividend Yield	1.40%	1
S&P 500 P/E Ratio (Trailing 12 mos.)	55.1	4
S&P 500 P/E Ratio (Next 12 mos.)*	21.5	2
First Call Earnings Surprise*	3.28%	5

*First Call Corp.

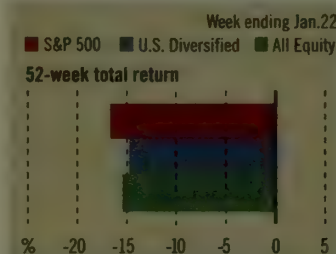
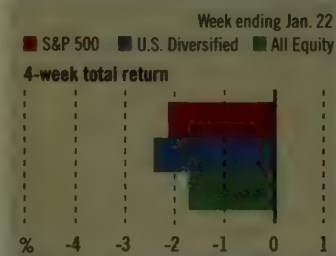
TECHNICAL INDICATORS

	Jan. 22	Wk
S&P 500 200-day average	1166.4	116
Stocks above 200-day average	55.0%	5
Options: Put/call ratio	0.73	0
Insiders: Vickers Sell/buy ratio	2.72	2

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Wireless Services	-21.2	Multi-Utilities
Photographic Products	-16.1	Computer Stge.
Conglomerates	-11.7	Telecomms. Equ.
Oil & Gas Drilling	-10.2	Wireless Service
Constr. & Engineering	-9.9	Instrumentation

Mutual Funds



Data: Standard & Poor's

Interest Rates

KEY RATES

	Jan. 23	Week
MONEY MARKET FUNDS	1.69%	1.73
90-DAY TREASURY BILLS	1.69	1.60
2-YEAR TREASURY NOTES	3.01	2.79
10-YEAR TREASURY NOTES	5.03	4.84
30-YEAR TREASURY BONDS	5.47	5.39
30-YEAR FIXED MORTGAGE†	6.96	6.86

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.27%
TAXABLE EQUIVALENT	5.19
INSURED REVENUE BONDS	4.44
TAXABLE EQUIVALENT	5.43

THE WEEK AHEAD

DURABLE GOODS ORDERS Tuesday, Jan. 29, 8:30 a.m. EST ► New orders for durable goods probably increased 1.5% in December. That's based on the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies.

FOMC MEETING Tuesday, Jan. 29, 9 a.m. EST ► The Federal Reserve Board's Open Market Committee will meet for two days to set monetary policy. Three quarters of the economists surveyed by S&P's MMS

forecast a further quarter-point cut in the federal funds rate, to 1.5%.

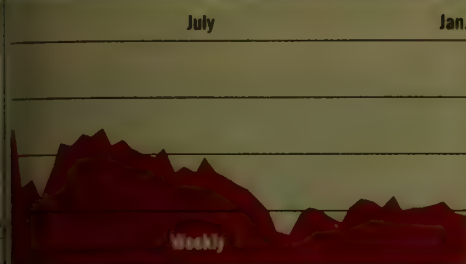
CONSUMER CONFIDENCE Tuesday, Jan. 29, 10 a.m. EST ► The Conference Board's confidence index probably climbed to 96 in January, up from 93.7 in December.

GROSS DOMESTIC PRODUCT Wednesday, Jan. 30, 8:30 a.m. EST ► The economy is estimated to have contracted at an annual rate of 1.2% in the fourth quarter after shrinking by 1.3% in the third quarter.

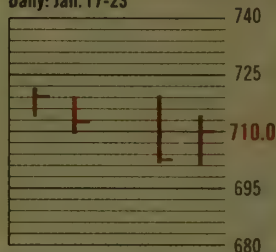
EMPLOYMENT COST INDEX Thursday, 8:30 a.m. EST ► Compensation fourth quarter likely rose by 0.1%.

EMPLOYMENT Friday, Feb. 1, 8:30 a.m. EST ► Nonfarm payrolls probably dropped 60,000 jobs in January, pushing employment rate to 5.9%.

PURCHASING MANAGERS' INDEX Friday, 10 a.m. EST ► The Institute for Management's January industrial index likely climbed to 49.6%.



Daily: Jan. 17-23



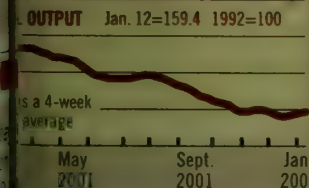
0.5% for the week through Jan. 23. All eyes, however, were on the widely held Tyco International, announced a plan to split itself into four separate companies, in effect undoing a decade of deal-companies, such as ExxonMobil, Apache, and Occidental Petroleum, were up about 1%, while software maker Mercury Interactive led the gainers, rising 10.9%.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
National Petroleum	-3.4	-17.4	26	Verizon Communications	-0.4	1.5
	-3.3	-25.0	27	Citigroup	1.3	1.7
	-13.0	-70.8	28	Sun Microsystems	-6.9	-43.8
	4.5	-47.7	29	Merck	0.1	-27.0
Materials	-0.7	-9.0	30	El Paso	-5.1	-46.5
Financial	-6.7	-91.8	31	Altera	0.4	-8.5
Petroleum	0.8	5.5	32	Marsh & McLennan	-0.9	-2.9
	1.0	-12.4	33	Household International	-1.4	-8.6
	-0.2	-18.8	34	ChevronTexaco	0.6	1.0
	1.0	-21.6	35	SBC Communications	-1.8	-20.2
Others Holdings	0.1	-6.5	36	Mercury Interactive	10.9	-39.2
	-6.7	-66.1	37	AOL Time Warner	-2.9	-34.5
	-5.6	-72.3	38	Washington Mutual	2.3	2.7
Laboratories	4.3	24.1	39	General Dynamics	5.5	18.0
Financial	3.1	-15.1	40	Comcast	-2.4	-18.3
Technology	-5.4	-11.9	41	Morgan Stanley Dean Witter	-0.7	-12.8
	-1.6	-2.1	42	Tellabs	-0.6	-64.5
Mass	-2.0	-19.6	43	Exxon Mobil	1.1	-4.4
Media	-6.3	-13.9	44	Scientific-Atlanta	2.4	-46.8
Communications	-2.6	-56.3	45	U.S. Bancorp	3.8	-10.0
Financial	-3.8	-6.8	46	Paychex	-3.3	-9.1
Petroleum	1.8	10.0	47	Merrill Lynch	-0.8	-8.5
Services	-1.6	1.9	48	Bed Bath & Beyond	1.9	28.7
Services	-2.3	-23.1	49	Texas Instruments	-1.0	-19.8
Health	8.4	2.3	50	Teradyne	-1.6	-8.7

Production Index

Change from last week: 0.3%
Change from last year: -10.7%



Index rose once again. Before calculating a four-week moving average, the index inched up from 158.9. On a seasonally adjusted basis, the index posted the largest gain, with autos, also rising significantly. Rail freight traffic rose due to increased vehicle shipments. Crude-oil refining dropped and electric power production were down.

For more information on the index components is at www.businessweek.com. Copyright 2002 by The McGraw-Hill Companies.

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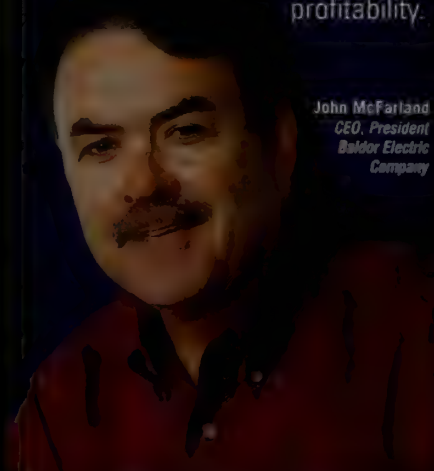
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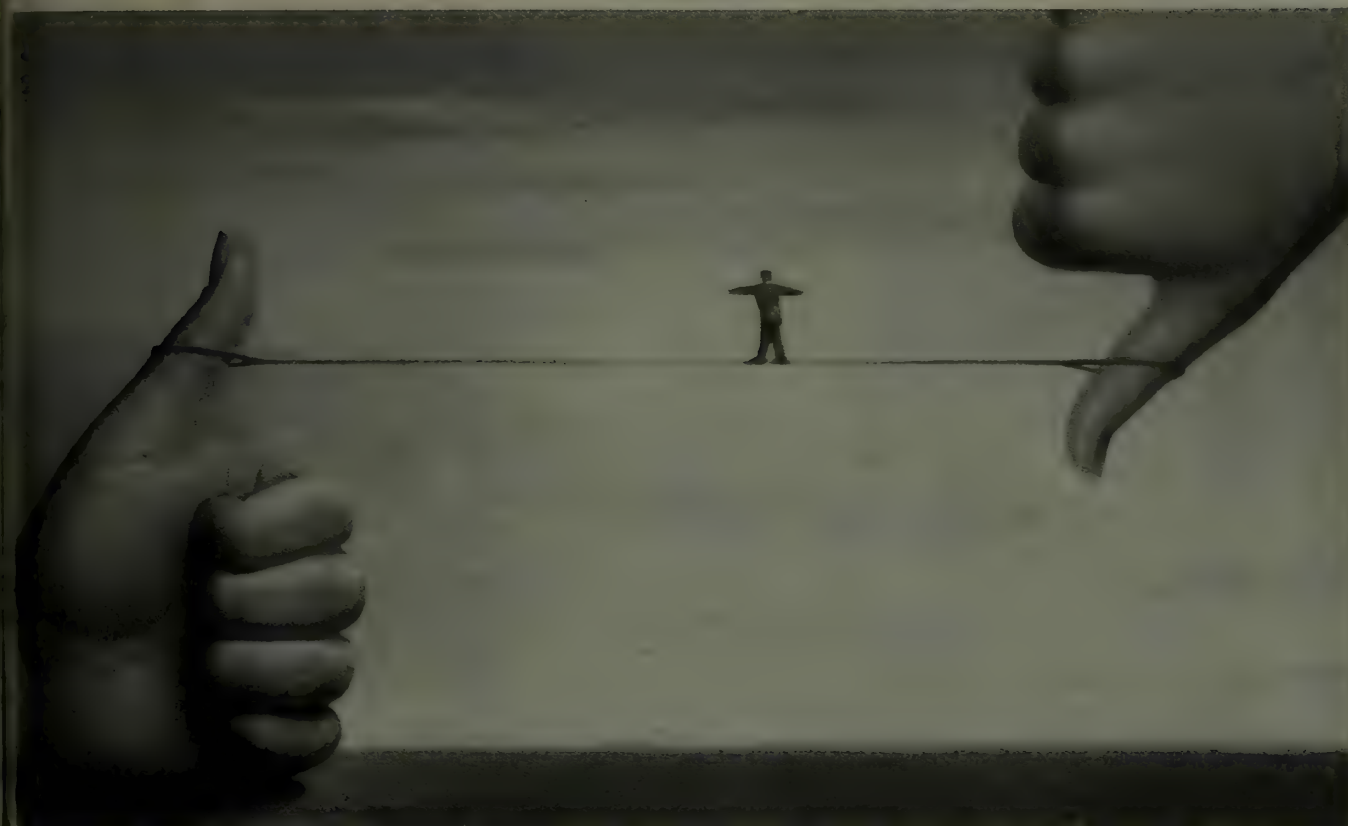
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THE POST-ENRON WORLD

A post-Enron era is beginning to take shape, and those chief executive officers and politicians who miss this change in the culture may find themselves suffering deeply. Enron Corp. clearly crossed the line—but it was a line that much of the country has been walking for a decade. The hyperbolic forecasts that various chief executives fed investors about their companies' prospects became sweeping deceptions by Enron officials. The accounting tricks that companies employed to boost earnings and stock prices became outright duplicity in Enron hands. And the campaign contributions spent by many companies to ensure favorable government treatment worked only too well in Enron's case.

The Enron scandal appears to be a watershed event. Polls show a deep undercurrent of public distrust in Big Business and its influence in Washington (page 34). Investors are already demanding a new veracity and integrity from chief executives and the balance sheets they present. The next impact, however, may be on the political world as voters question the money connection between Big Business and policymaking. President George W. Bush would do well to understand the change in the nation and follow his champion Theodore Roosevelt in cleaning up the mess in political finances. As he prepares his State of the Union message, the President should seize the moment to back campaign finance reform and reassure Americans that they can trust their elected leaders.

Americans want no less from their corporate leaders. The perfidy of Enron executives contrasts sharply with the post-September 11 honesty of former New York City Mayor Rudolph W. Giuliani and Defense Secretary Donald H. Rumsfeld, who became instant public heroes for their simple and truthful appraisals of terrible crises. Compare that to what Enron Chairman Kenneth L. Lay told *BusinessWeek* on Aug. 20: "There are no accounting issues, no trading issues, no reserve issues, no previously unknown problem issues. The company is probably in the strongest and best shape that it has ever been." Or compare that to what former Enron Chief Executive Jeffrey K. Skilling said to *BusinessWeek* on Aug. 23: "People are afraid there's another shoe to drop, but it's just not the case." Skilling resigned on Aug. 14, the day before an Enron vice-president, Sherron S. Watkins, wrote her now-famous memo warning of an enormous "accounting hoax." Enron filed for bankruptcy on Dec. 2, destroying the jobs and the retirement savings of thousands of people. Throughout this time, Lay and Skilling were selling their company's stock while advising investors and their own employees to buy it.

INVESTORS WANT HONESTY

In the immediate aftermath of the Enron fiasco, investors already have started demanding much greater clarity and honesty. Look at Tyco International Ltd., which was pressured to split itself into four companies and sell off assets because in-

vestors were uneasy about the reliability of the comparative accounting methods. Even a passing grade by the Securities Exchange Commission was not good enough to satisfy skeptical investors. Meanwhile, the credit-rating agencies demanding more off-balance-sheet information from companies. And stocks may well shift to a two-tier market in which investors reward companies that choose to return to conservative accounting practices and punish those that don't. Days of slippery pro forma accounting are numbered.

Washington should get behind the move toward more transparency and honesty in the country's corporate bookkeeping. The ability of companies to game the entire regulatory process that Enron did, must be prevented in the future as well. The Securities & Exchange Commission should be leading the effort, but it isn't. The attempt of the SEC's chairman, L. Pitt, to constrain rogue accounting firms that enable companies to distort their earnings is pitifully weak. He suggests yet another oversight committee to check procedures of a profession that already has a half-dozen such groups, which has stopped the many accounting scandals of the past years. Pitt's background in representing dozens of major companies, including ones in the accounting industry, in the SEC regulation make his job all the more difficult (page 35).

THE SEC SHOULD ACT

Pitt is unquestionably a man of personal integrity. He needs to come forth with a far bolder reform plan. The integrity of our financial markets is at stake.

Beyond that, there is no way to ensure honesty in Washington under the current system of campaign finance. It is impossible to establish arm's-length decisions in the political interest when raising campaign money is constantly on the agenda. The Clinton Administration encouraged chief executives to fly abroad with Commerce Dept. officials to secure overseas contracts. Their goal was laudable: to compete with Japanese and European government efforts to help American corporate "national champions." At the same time, Clintonites were asking those same honchos flying overseas for campaign contributions. Enron's Lay flew to India to secure a \$3 billion energy contract. He gave generously to Democrats and Republicans alike. Did he get what he paid for? We can't know for sure. Which is precisely the point.

In the post-Enron environment, Americans are reevaluating their financial and political assets—and finding both severely depreciated. Investors are already betting their dollars on more trustworthy companies and CEOs. Voters may be doing the same with their political parties and elected officials. As said in 1910 that "our government, national and state, freed from the sinister influence or control of special interests." After Enron, President Bush should take these words to heart.

Business Week
February

ED WEEKLY COVER



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BusinessWeek

1, 2002

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IBM'S NEW BOSS

Sam Palmisano
has a tough act
to follow. Here's
what to expect.

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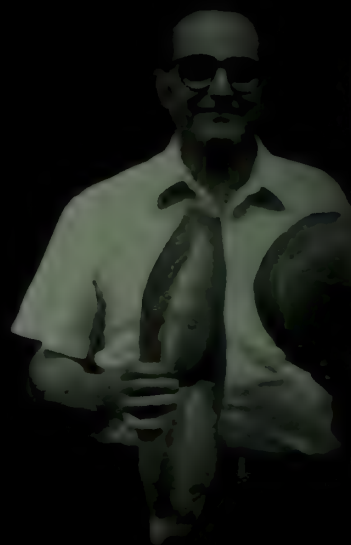
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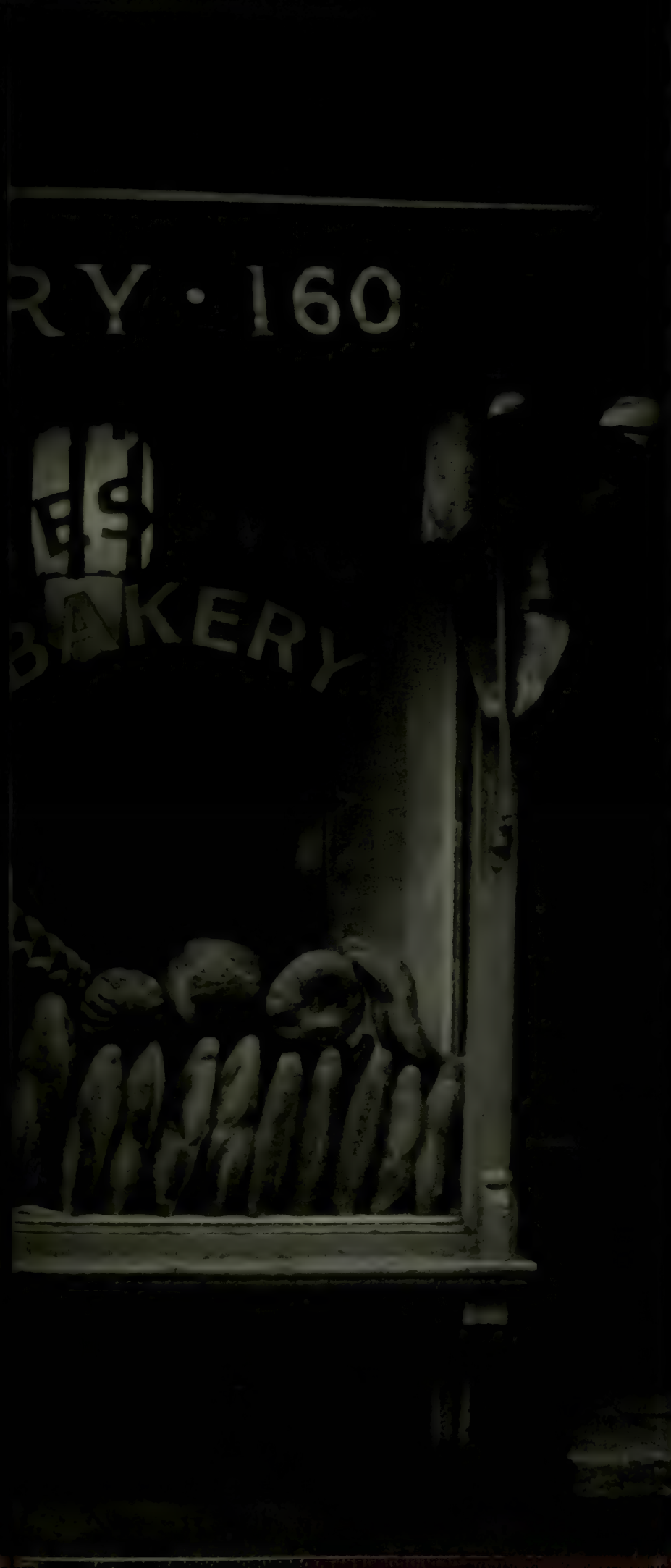
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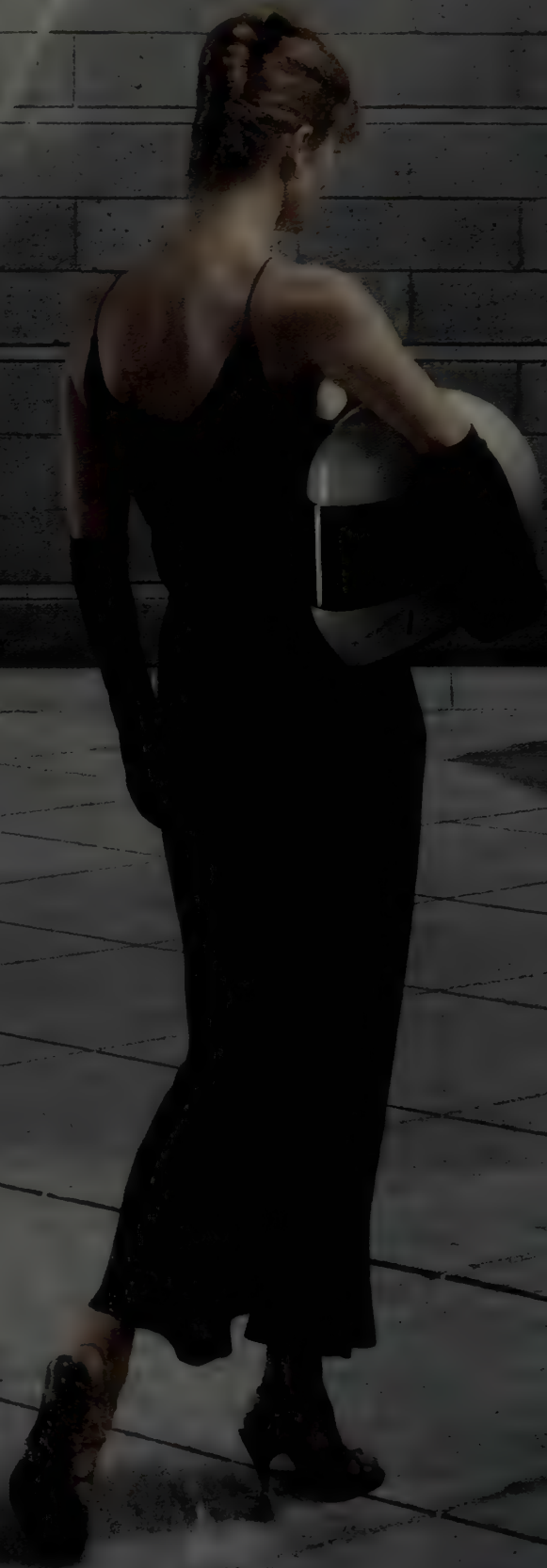
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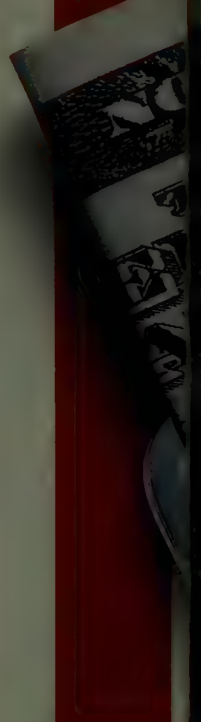
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It has been nearly three years since we launched our expanded personal-finance section, called *BusinessWeek Investor*. The successor to our long-running *Personal Business* section, *BusinessWeek Investor* offers advice on a vast array of investments and addresses every facet of your financial-management needs. Senior Editor Jeffrey M. Laderman and Associate Editor Amy Dunkin lead an experienced team of writers, editors, and columnists, including Robert Barker of "The Barker Portfolio," Toddi Gutner of "Hers," and Gene G. Marcial of "Inside Wall Street."

Most *BusinessWeek* readers know that when they're looking for news on matters of personal investing, they can simply turn to the back pages of the magazine. Now, to make it easier than ever to find this information, we have fashioned a new weekly supplement, complete with its own distinctive cover page.

This supplement will retain the *BusinessWeek Investor* name and will still occupy its prized spot in the back. It will also carry the tag line "Making Life Richer" to reflect the inclusion of the *BusinessWeek Lifestyle* section. *BusinessWeek Lifestyle* covers personal technology, travel, cars, health, and other topics that affect our readers' personal lives, yet still figure into their financial well-being.

Our first newly enhanced section, appearing this week, features a cover story by Staff Editor Lewis Braham on a different way to decide whether or not to buy a stock. Using a measure known as the "implied growth rate," we found that the earnings-growth expectations built into the prices of many large stocks are unrealistic. As a result, you may want to steer clear of these companies. Also in *BusinessWeek Investor* this week: our annual report on closed-end funds, a review of new investing books, and in "The Barker Portfolio," what to expect from the new manager of the T. Rowe Price Science & Technology Fund.

In this issue, we also present *BusinessWeek Lifestyle's* personal technology special report. Leading our lineup is a first-person account by Computers Editor David Rocks—telling about how he set up a wireless network for all of his personal computers at home. The system lets his PCs swap files and use a single high-speed connection to gain access to the Internet from anywhere in his house. But as Rocks discovered, the process of installing a network can be frustrating and infuriating.

In addition to the new weekly supplement to the magazine, a number of other activities are advancing *BusinessWeek's* investing and lifestyle coverage. The year-old Investing channel at *BusinessWeek Online* (www.businessweek.com) offers a daily mix of financial-news analysis prepared by the magazine staff and investment advice from experts at Standard & Poor's, which, like *BusinessWeek*, is a division of The McGraw-Hill Companies.

Along with other partners, the site also supplies scads of financial data, a portfolio tracker, three stock screeners, personal finance calculators, S&P Stock Reports, a mutual-fund scoreboard, and a corporate events and earnings calendar. Then there's the newest addition to our lineup, *BusinessWeek TV*, a weekly syndicated show that focuses on personal investing. For stations and times, go to www.businessweek.com/bwtv/.

Through all of these efforts, we seek to provide the best possible information and tools to help you manage your investments and personal affairs. Please check out our new look: The *BusinessWeek Investor* supplement starts on page 81.

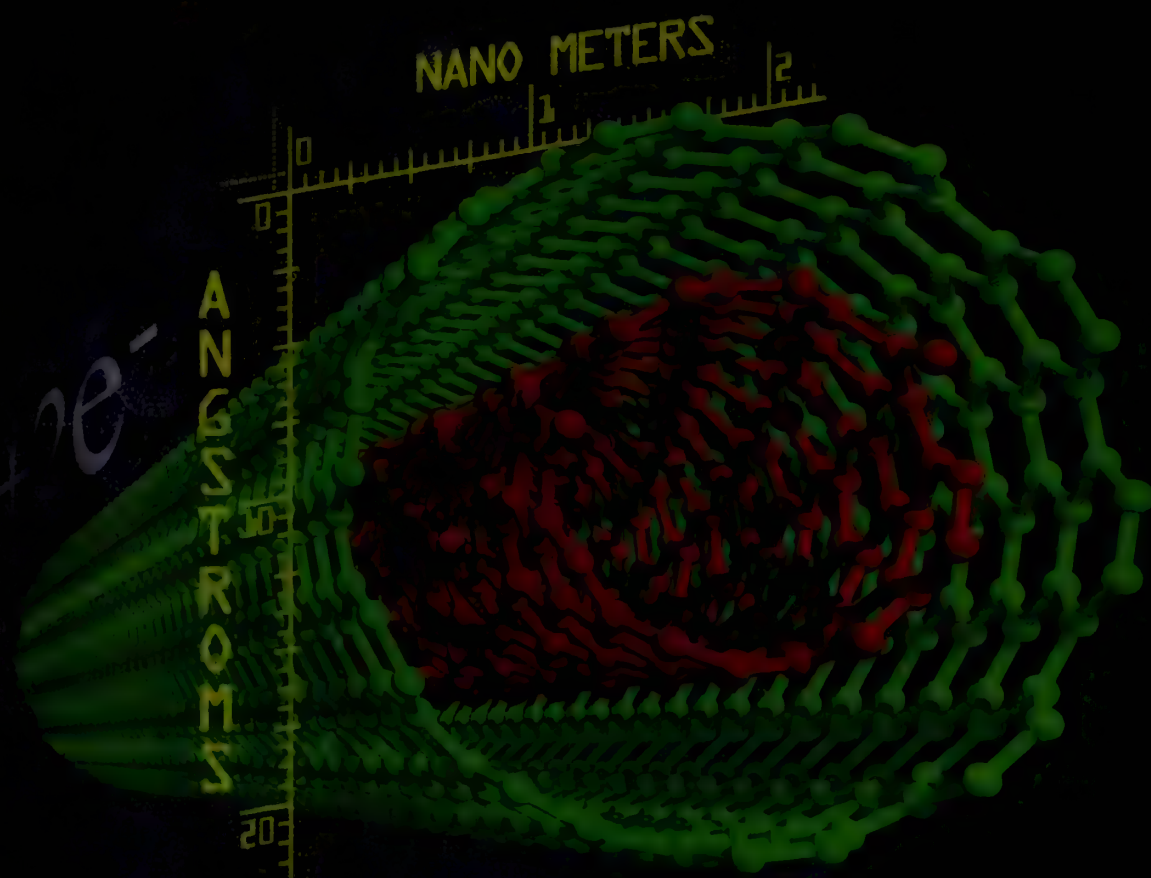
Stephen B. Shepard

Editor-in-Chief



NEW LOOK: Inside this issue

Innovative Solutions



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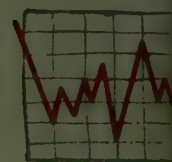
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How do you follow an act like Lou Gerstner's? That's the \$86 billion question for Sam Palmisano, who on Mar. 1 becomes IBM's eighth CEO. Despite a disappointing fourth quarter, the service-heavy model that Gerstner built is the envy of techdom. Still, Palmisano, the operations whiz whom Gerstner has long depended on, faces daunting challenges. PCs, disk drives, and chips are problems. Consulting is slowing. And some wonder whether Palmisano has an overarching vision for IBM. Here's what to expect

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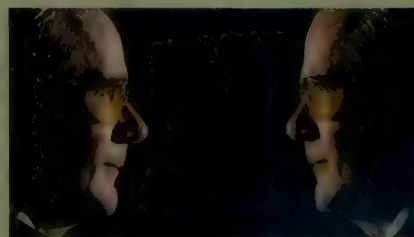


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Investors are too spooked by bad news—and too excited by good news, says BW's Gene Marcial



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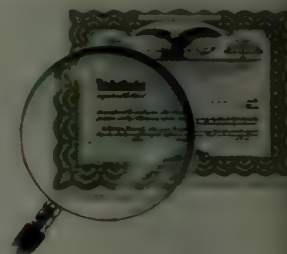
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Investors' New Worry

Before putting your money down on a stock these days, better consider an additional risk factor: Which accounting firm is the company using to keep its books?



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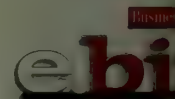
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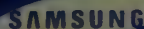
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Up Front

EDITED BY SHERIDAN PRASSO

GREEN SCENE

CHENEY FUMBLES THE SIERRA CARD

WAS THE BUSH ADMINISTRATION too cozy with Enron and the oil industry when it devised its energy plan? Vice-President Dick Cheney says no—that the Administration included views from environmental groups as well. “Look at the Sierra Club,” he claimed on CNN on Jan. 28. “They had an energy policy that had 12 recommendations in it; 11 found their way into our report.”

But just ask the executive director of the Sierra Club, Carl Pope, what he thinks of that statement. “It’s not true,” says Pope, who found only one of his recommendations there. “Their plan went



CHENEY: *The Sierra Club begs to differ*

in the opposite direction of our recommendations.”

The Sierra Club recommendations included increasing gas-mileage standards by more than 50%, to 40 mpg,

TALK SHOW “We just received a message from Saddam Hussein. The good news is that he’s willing to have his nuclear, biological, and chemical weapons counted. The bad news is, he wants Arthur Andersen to do it.” —President

for cars and SUVs, and certain tax incentives for energy-efficient buildings and solar power. It also asked for tighter air-pollution controls on power plants.

None of those is in the Bush plan. Interestingly, the only one that did make it had to do with maximizing production from existing oil wells.

So why is Cheney saying this? “He likes to bring the Sierra Club out of the closet and say how much he agrees with us when he thinks he’s in trouble,” says Pope. “I assume he thinks he’s in real trouble.” The Vice-President’s office did not respond to calls seeking comment. *Paul Raeburn*

SLUGFESTS

LINDA LAY: TALK OUT OF COURT

THROUGH TEARS, LINDA LAY told viewers of the show that her husband did nothing wrong in the Enron collapse. “Never, not for one second, he have allowed anything go on that was illegal,” she said in the Jan. 28 broadcast. “There are some things that weren’t told.”

But could the interview actually hurt her spouse in court? Legal experts say there’s a chance that the decision to talk about the Enron scandal may have caused the company to partially waive some



LINDA LAY: “Never, not for one second, he have allowed anything go on that was illegal.”

called “marital privilege.” That’s the law giving the right not to testify about private confidences.

Because Linda Lay’s thoughts with a national TV audience, a judge may conclude that he intended them to be confidential, says Harvard Law School’s Alan Dershowitz. “You can’t turn on the tape and then turn it off at will,” he says.

As a result, she risked being compelled to tell a civil court about other things Ken said, as Enron was sliding toward bankruptcy. But all that’s lost. She probably could have been compelled to testify in federal court, where stakes are higher. *Mike Ivers*

PAY CHECK

BYE, BYE, DAYS OF WINE AND BONUSES

POOR MASTERS OF THE universe. After giving themselves average raises of 14% in 2000, Wall Street’s CEOs will find, when proxy statements are tallied by March, that they’ve taken a 45% cut in 2001, according to estimates from compensation consultant Johnson Associates.

Yet in percentage terms, chief execs are faring better than some of their Street underlings. Even though employees overall are earning 30% less on average, managing directors are taking a 55% cut in bonuses, restricted stock, and options, according to the same estimates. Still, it’s probably easier for a managing di-

rector earning \$4 million to get by on a mere \$1.8 million than for beginning associates (absorbing a 20% cut) who used to earn \$150,000 to now pull in \$120,000—especially when a greater proportion of their pay is now likely to be in options as investment

banks try to save cash.

Things could get even worse if companies fire more workers in another round anticipated in March. Says Salomon Smith Barney financial services analyst Guy Moszkowski: “It’s not really clear what employment alternatives people have at this point.” These days, even part of a salary beats nothing at all. *Emily Thornton*

THE LIST THE PAIN, THE PAIN

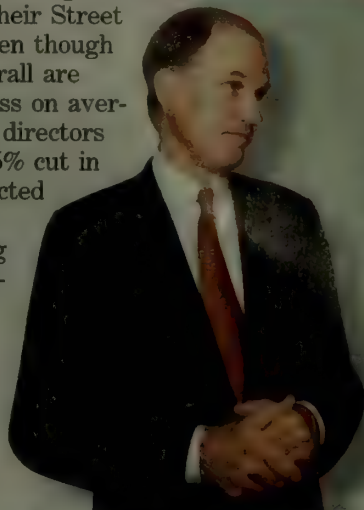
Wall Street CEOs ended up taking big pay cuts last year. Here’s how their compensation stacked up, compared with stock performance.

CEO/ COMPANY	2000*/ % CHANGE**	2001/ % CHANGE	2001 STOCK PERFORMANCE
WILLIAM HARRISON J.P. Morgan Chase	\$41.8 +32%	\$12 -71%	-20%
DAVID KOMANSKY Merrill Lynch	\$32.7 +59%	\$15.3 -53%	-24%
HENRY PAULSON JR. Goldman Sachs	\$22.4 -11%	\$14.5 -35%	-13%
PHILIP PURCELL Morgan Stanley	\$27.7 +4%	\$16 -42%	-29%

*Millions

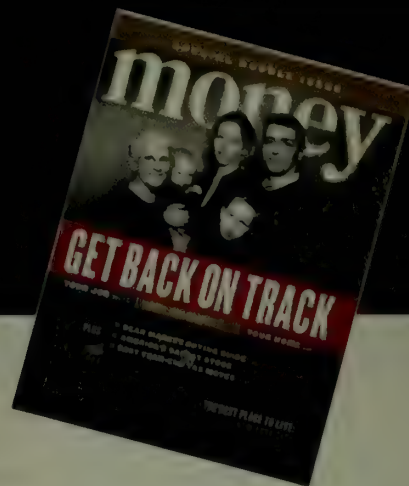
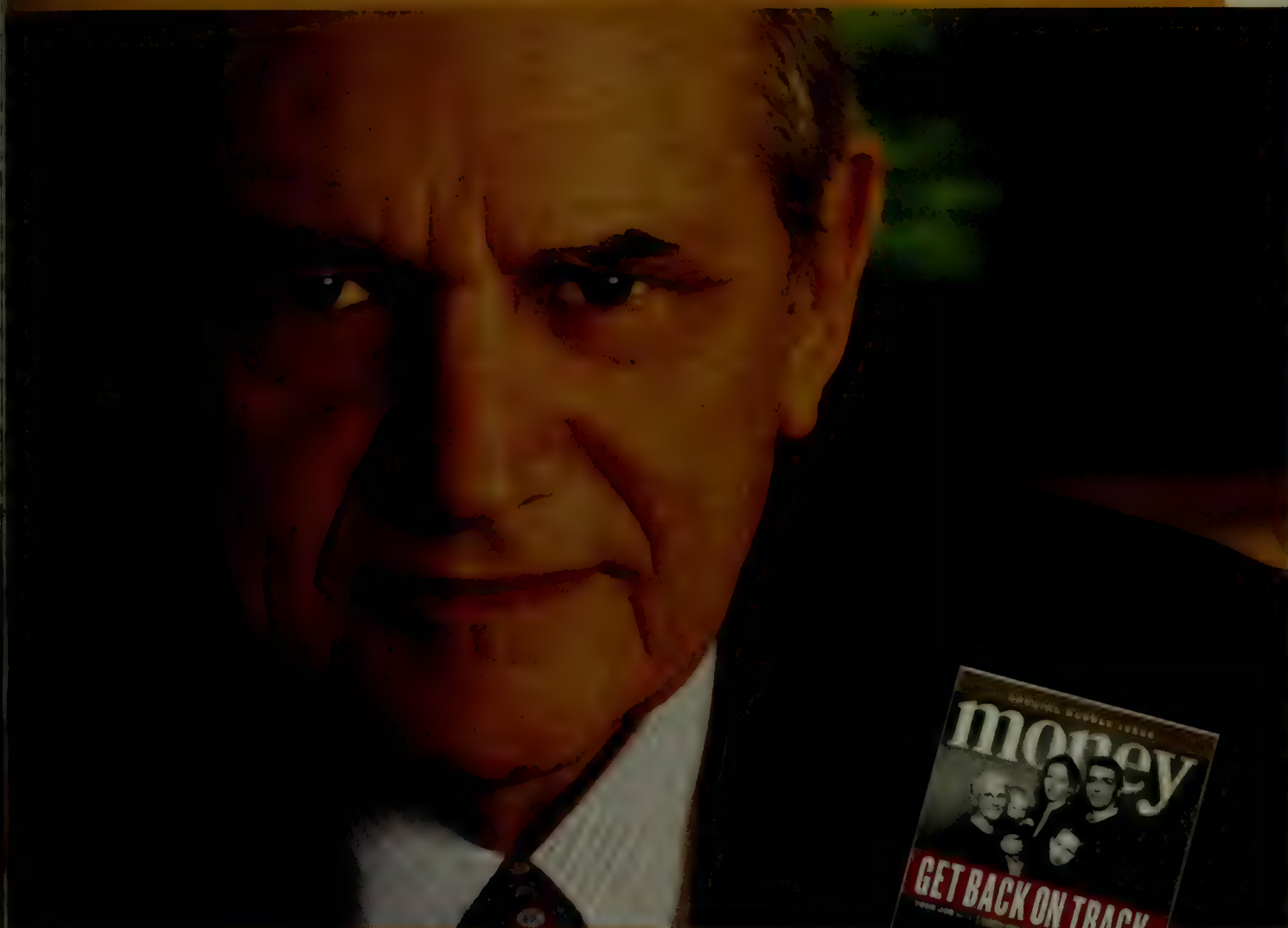
**Over 1999

Data: Johnson Associates, *Forbes*, Bloomberg Financial Markets



HARRISON: A 71% haircut

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Up Front

HALLS OF IVY

YOUR ALMA MATER IS A VENTURE CAPITALIST

LAST YEAR, LIKE MOST investors, university endowments lost money. Their get-well strategy: shift more of their \$400 billion in assets away from publicly traded stocks and into riskier investments such as hedge funds and venture capital.

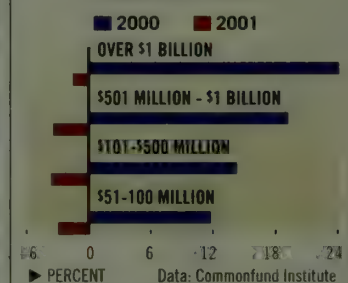
Big, multibillion-dollar endowments, including those at Notre Dame and Vanderbilt universities, have been in-

creasing alternative investments over the past five years, investment officers say. Now, smaller endowments in the \$500 million to \$1 billion range are doing it, too. Ohio State University, for example, plans to double, to 15%, the part of its \$1 billion endowment in venture-capital funds and in small local companies by the end of this year, says Assistant Treasurer Pranab Bhattachary.

Large endowments typically have much better returns than smaller ones (chart), which they attribute to alternative investments.

BIGGER, BETTER

Investment returns by endowment size:



"It's very hard to beat the broader market with a plain-vanilla stock portfolio," says Scott Malpass, chief investment officer at Notre Dame, which has boosted the share of its \$3 billion endowment invested in alternatives from 30% to 40% over the past five years.

The trend is likely to continue, according to an upcoming study from the Commonfund Institute, a research center. The average endowment currently has 26% of its assets in alternative investments. That, says Institute Director John Griswold Jr., is expected to jump to 35% in the next five years. Alternative investments, he says, "will creep into the smaller endowments as they get the message that this is a good thing." *Kimberly Weisul*

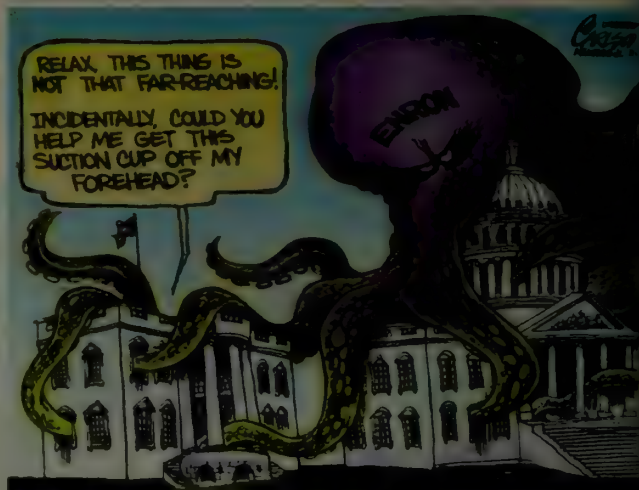
AS THE DOWNTURN TURNS

PARENTS ACROSS THE U.S. may soon face growing laundry piles and emptier-than-usual refrigerators. An unprecedented number of college grads this year will be moving back in with Mom and Dad. A national survey of 3,000 college students by career Web site Monster.com found 60% plan to head home after graduation, vs. 56% last year. The jobless rate for 20- to 24-year-olds is 9.6%, nearly double the national average.

One boomerang kid, Cornell University senior Jaret Posmentier, plans to sack out at his parents' house in Croton-on-Hudson, N.Y., 45 minutes north of New York City. His goal: find a job in television production, save up some money, and move into the city after that. What do his parents think about his impending return? Says Posmentier: "They're looking forward to having me back. But we'll see after a year or so how excited they still are."

Julia Cosgrove

DRAWN & QUARTERED

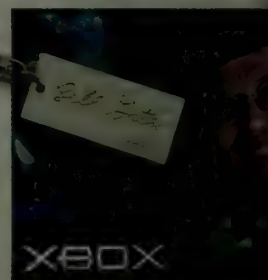


BIG IN JAPAN

NEXT, BILL GATES AIR FRESHENERS?

NO EXEC IN THE WORLD rivals Microsoft's Bill Gates when it comes to celebrity. So as Microsoft jumps into the gaming world with its Xbox console, it wants to lure buyers with the chairman's global renown. When Xbox launches in Japan on Feb. 22, Microsoft will offer 50,000 limited editions (\$306) that come with extras not available in the U.S. version, such as a black translucent case and an accessory for playing on high-definition TVs. But the gewgaw that Microsoft hopes will separate Xbox from rivals Sony and Nintendo on their home turf is a silver-plated key chain with Gates's engraved signature.

Japanese fans, it can't get enough Bill. research found Tokyo sumers loved the key despite its low-tech "Bill has a celebrity st Japan," says John O'I director of Xbox sale



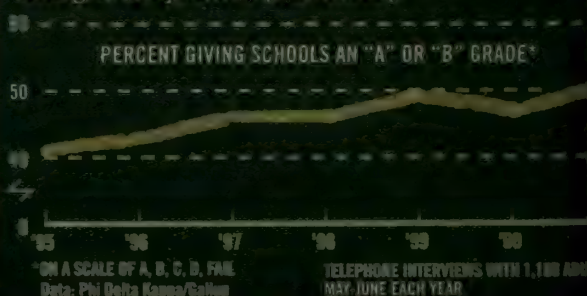
KEY CHAIN and cult fi

marketing. Witness appearance at the Game Show in Janua he walked the floor, mobbed by gamers ea glimpse the world's we man. Now they can autograph, too. *Jay*

THE BIG PICTURE

GOOD GRADES FOR PUBLIC SCHOOLS? YES

More than half of Americans perceive their local public schools to be good or excellent—the highest rating in the poll's 33-year history



Polls, surveys, and other items for this section should be sent to upfront@businessweek.com

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GETTING TO THE BOTTOM OF CISCO'S NUMBERS

"Cisco: Behind the hype" (Cover Story, Jan. 21) quotes Abraham J. Briloff, professor emeritus at Baruch College, as saying that Cisco Systems Inc. "suppressed a grand total of \$18.2 billion in costs" when it accounted for certain acquisitions by the pooling-of-interests method. Yet you challenge accounting for the \$3.8 billion in research and development write-offs as purchases—which suggests that using either method is somehow inappropriate.

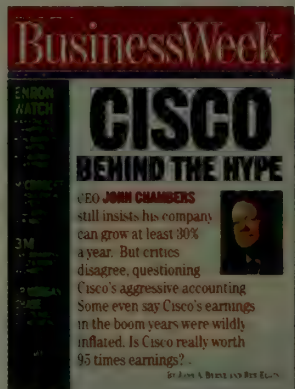
I'm sure that "Cisco follows generally accepted accounting principles" would be a less engaging story. Until the Financial Accounting Standards Board issued new rules as of July 1, 2001, companies were required by GAAP to account for acquisitions as poolings when certain, highly restrictive criteria were met, and as purchases when they were not. Neither Cisco nor any other company had a free choice in accounting for mergers—accounting as a pooling or purchase was dictated by the terms of the deal. And GAAP required immediate write-off of in-process R&D acquired in a purchase.

Dennis R. Beresford
 Professor of Accounting
 University of Georgia
 Athens, Ga.
Editor's note: The writer is former chairman of FASB.

Larry R. Carter, Cisco's chief financial officer, maintains that pro forma numbers portray the company's operating results more accurately—because they exclude volatile charges, such as acqui-

sitions. Carter says: "It's sort of 'What do you like, vanilla or chocolate? We're going to give you both, and you can choose.'" *BusinessWeek* points out that "in the latest of more than a third of Cisco's pro forma earnings come not from operations but from interest and other income." If it comes to "operating results," it's as if Carter and CEO John Chambers are serving a generous helping of pie in the face of investors.

Robert Butcher
 Irvine, Calif.



I applaud "One accounting code for all" (Editorial, Jan. 21). However, your divisive views of pro forma earnings in "Cisco: Behind the hype" are off the mark. Our professional accounting community, Financial Executives International, along with the National Institute of Standards and Technology, published guidelines on the use of such metrics last year.

When abused, any reporting to be harmful to investors. When used constructively and in compliance with FEA/NIRI guidelines, such metrics provide much-needed information to investors. In fact, pro forma earnings try to show the cash flow and operating earnings you call for in the editorial.

Philip B. Livni
 President and
 Financial Executives International
 Morristown, N.J.

Your article did justice to the hype but failed to mention the tens of millions of dollars Cisco off-loaded to its wireless partners. On Nov. 15, Cisco stunned its "Advanced Technology Partners" by unilaterally announcing

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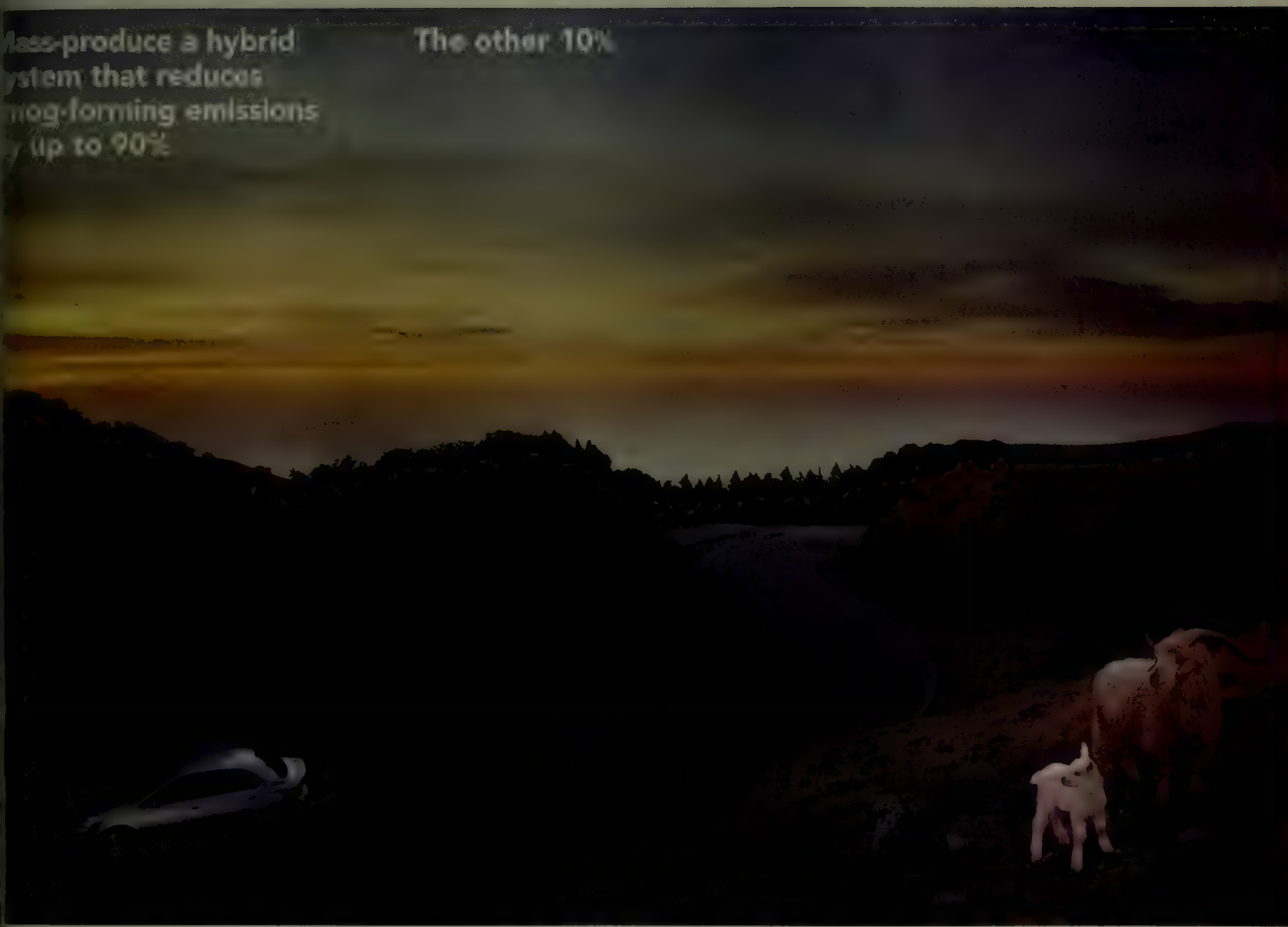
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Readers Report

CORRECTIONS & CLARIFICATIONS

"One big client, one big hassle" ("The Enron scandal," Special Report, Jan. 28) should have said that Vinson & Elkins declined to comment on Enron Corp.'s investigation of allegations of accounting fraud by Sherron S. Watkins because of attorney-client privilege.

The name of a Bank of China employee was misstated in "The black hole" (International Business, Feb. 4). The correct name is Xu Chaofan, not Fan Xuchao.

the WT-2750 product line was immediately end-of-life and end-of-sales. This is creative accounting at its finest: Get others to make and sell products you have branded so you can hype your stock as a "service-provider partner" and let others take the losses.

Ken McLeod
Chief Executive Officer
CSG Wireless Inc.
Mesa, Ariz.

I could not suppress a wry smile when I read about Cisco and learned that as the second [fiscal] quarter closed, CFO Carter oversaw a rush to cram machines on trucks so they would be counted as "sold."

About 18 years ago, when I was working for Wang Laboratories Inc. in Lowell, Mass., I remember rumors about the same practice: trucks driving around with unfinished inventory so that it could be counted as sales and maintain Wang's "phenomenal" growth. Sadly, it didn't help in the long run, and Wang disappeared, taking a large number of employee pensions with it, including mine. Curiously, Cisco CEO John Chambers was a senior vice-president at Wang around that time and obviously learned some lessons very well—but clearly not quite well enough.

Jon Wilkie
Weybridge, England

Industry insiders have known for years about the hype and house of cards at Cisco. That hype manifests itself in such a way that customers exclude or delay implementation of competitive offerings in lieu of evolving technology offered by Cisco. Customers fear that by making a competitive selection, they may harm their careers—particularly if John Chambers flies in to meet with their top company officers.

Lawrence Strawley
Unionville, Pa.

There are more than 7.3 billion shares of Cisco outstanding, and probably many more to be issued to Cisco employees in the future through stock options (not accounted for on the income statement). To make even 50¢ per share, implying a 40 price-earnings ratio at today's prices, Cisco would have to earn more than \$3.6 billion aftertax. The most Cisco ever earned in a single year on a GAAP basis was \$2.7 billion, at the height of the Internet/telecom boom. The lesson to be learned is that accounting can delay, but not eliminate, the true costs of doing business.

Murray Kenney
San Francisco

Is it your plan to scare every investor? I think you are trying to relate Cisco to Enron Corp.—it's not even close. The fact is, *BusinessWeek* will be long gone before Cisco is.

Jamie Dvorak
Pierce, Neb.

ANTI-SEMITISM IS HARDLY A THING OF THE PAST

Hardy Green's review of Neil Baldwin's *Henry Ford and the Jews*, concluding that overt anti-Semitism has been relegated to "the distant fringe of U.S. life," is disconcerting ("A titan of industry—and a bigot," Books, Jan. 21). One only has to review the tapes of President Richard M. Nixon 21 years after Henry Ford's death to see that the problems of anti-Semitism are too real. Nixon and his aide H.R. Halde- man wanted to have the Internal Revenue Service investigate all the big Jewish contributors to the Democrats. Nixon favored finding a zealot, who disliked Jews, to go after them.

Ford was a bigot, and he didn't get enough flak from U.S. Jews, as he should have. The Ford Foundation is fully aware of its founder's past and is generous in supporting Jewish causes to make up for the harm Henry Ford created with his anti-Jewishness.

William J. Levy
National Director
Organization of World Jewry
Allentown, Pa.

Henry Ford may have been "America's most notorious anti-Semite," as correctly pointed out in Hardy Green's fine review of Neil Baldwin's book, but all of Detroit and the American auto industry were rife with Jewish hatred and bias. In the 1930s, my grandfather changed both his religion (Jewish to Protestant) and his given name (Abraham to Ed-

ward) so that he could advance Hudson Motor Car Co. He would have been made president of that company if the truth were known.

Stephen R.
Morris,

HOW CAN YOU DOWNGRADE TO 'ATTRACTIVE'?

I found "Will investors pass Schwab's advice?" (News: Analysis Commentary, Jan. 21) informative, took particular note of the stock grade. On Jan. 7, analyst Amy S. of Bear Stearns & Co., downgraded stock from a "buy" to "attractive." What does "attractive" mean? 2001 net income projected to be less than 2000, you would hope good deal more clarity. What next level: "cute"? And then do move toward "dowdy"?

David
Somers,

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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

FINALLY, A NO-HASSLE, NO-STRAIN COMPUTER



The excellent new iMac cures our greatest ergonomic ill

Apple Computer Inc. long ago demonstrated that computers don't have to be ugly. And the new iMac, which is an excellent computer at a competitive price, is yet another striking example of the Apple tradition. But this time, Apple is taking on an even more important question: Why do computers have to be uncomfortable to use?

Other than a bad chair, nothing contributes more to the discomfort of computer use than an improperly positioned screen, which can cause problems from eye strain to backaches. Ideally, you want the display at eye level and at a distance and angle appropriate for the task at hand. Yet most displays allow limited adjustment, and some, notably Apple's original iMac and its flat panel displays, provide for no adjustment at all.

What took them so long? "We are very encouraged that the solution looks very simple and very obvious," says Apple design chief Jonathan Ive. Adds Jon Rubenstein, Apple senior vice-president for hardware: "It was a lot harder than it looks."

The key to the iMac is a very clever piece of hardware of the old-fashioned nuts-and-bolts variety. The iMac consists of three basic components. A system unit, about the size and shape of half a basketball, contains all the circuitry, drives, and connectors. The display is a 15-in. flat panel screen surrounded by a clear plastic bezel that makes it seem to float. A metal "neck" about 8 in. long and 1½ in. in diameter joins the two.

The patent-pending neck is the secret of the design. Apple is stingy with details on how it works, but Rubenstein describes it as "a frictionless counter-balance." It rotates through 360 degrees horizontally and pivots 90 degrees vertically. The screen itself tilts about 30 degrees on the end of the arm. The entire display moves effortlessly, and some clever geometry keeps the screen's angle vertically constant as the neck pivots.

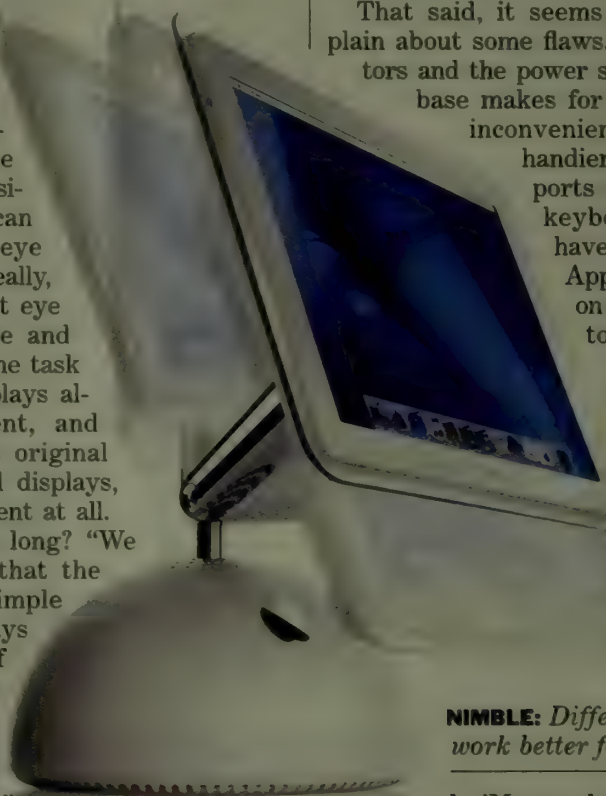
The result is a display that you can put just about any way you want. It glides to where you position it, without any bouncing or sagging. The impact of this design on the ergonomics of using a computer is dramatic. The ability to put the screen where you want to work without hunching over, a common problem with laptops, or, even more uncomfortable, without craning your neck back to view a monitor that is mounted too high for your cheap bifocals).

That's only the beginning. I found as I worked with the iMac that totally different positions worked best for different activities. For example, I like the screen nearly vertical at eye level. But I found that reading and Web browsing were more comfortable with the screen level and tilted back, the way I might place a book. The iMac makes this sort of adjustment seamless.

That said, it seems a bit churlish to complain about some flaws. Putting all the controls and the power switch on the back of the base makes for very clean looks, but it is inconvenient. It would have been handier with USB and FireWire ports in the front. A wireless keyboard and mouse have been nice. And will Apple ever go to the trouble of adding a touch on that brain-dead one-button mouse?

Functionally, the iMac differs from recent Macs chiefly in using the new OS X as the default operating system. You can run most programs written for previous versions, but they don't work as smoothly.

NIMBLE: Different screen positions work better for different activities.



The only iMac model currently available features an 800-megahertz PowerPC G4 processor, 256 megabytes of memory, a 60-gigabyte hard drive, and a combination DVD-CD recorder for \$1,799. (A similarly equipped Dell Dimension 4400 costs \$1,887.) Two other models at \$1,499, with slightly slower processors without the DVD recorder, are due in the couple of months. All of the configurations welcome departure from a longtime strategy of charging premium prices for Macs. These should give PCs a run for their money.

The original gumdrop-shaped iMac influenced computer design mainly by launching a plain transparent blue plastic high-tech product. I'll be very disappointed if coming months bring a flood of ergonomic display designs that mimic the iMac. Computer users of the future unite: You have nothing to lose but your strained and stiff necks.

BusinessWeek online

PHOTOS FOR THE REST OF US. For a look at Apple's new iPhoto software, go to Technology & You at www.businessweek.com/technology/

The Best-Sellers of 2001

BusinessWeek's list of 2001's top-selling books marks a transition: Digital Age titles, which made up a good portion of 2000's hardcovers, have disappeared. Instead, there's a cornucopia of self-improvement titles, available to help readers during these tougher times. And there's a reassertion of more traditional subject matter, including personal-finance, investing, and management how-tos, economics—and even an old-fashioned exposé.



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| HOW, DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • \$26) <i>How to bolster your true talents.</i> | 11 |
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|--|----|
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| 3 THE 9 STEPS TO FINANCIAL FREEDOM Suze Orman (Three Rivers • \$13.95) <i>Learn to save.</i> | 13 |
| 4 ORDINARY PEOPLE, EXTRAORDINARY WEALTH Ric Edelman (HarperBusiness • \$15) <i>Tips from some regular folks who became rich.</i> | 8 |
| 5 THE ONE MINUTE MANAGER Kenneth Blanchard, Spencer Johnson (Berkley • \$12.95) <i>Management techniques in story form.</i> | 62 |
| 6 THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$7.99) <i>The simple ways of the wealthy among us.</i> | 80 |
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| 8 GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$14) <i>A Harvard team's step-by-step guide to conflict resolution.</i> | 78 |
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| 11 1001 WAYS TO REWARD EMPLOYEES Bob Nelson (Workman • \$10.95) <i>Brunch, anyone?</i> | 39 |
| 12 BUILT TO LAST James C. Collins, Jerry I. Porras (HarperBusiness • \$16) <i>How 3M, Wal-Mart, and others became standouts.</i> | 48 |
| 13 RICH DAD'S RICH KID, SMART KID Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$15.95) <i>Start 'em early.</i> | 3 |
| 14 THE LEXUS AND THE OLIVE TREE Thomas L. Friedman (Anchor Books • \$15) <i>Globalization and its discontents.</i> | 13 |
| 15 THE 48 LAWS OF POWER Robert Greene (Penguin • \$15) <i>Thoughts of power brokers distilled.</i> | 7 |

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• **invent**²

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Future > Status Quo



BY GARY S. BECKER

DEFICIT SPENDING GOT ARGENTINA INTO THIS MESS



WET INK:
Printing pesos now will ease government budgetary problems—but pave the way for a return to inflationary patterns

The people of Argentina have suffered enormously from political mismanagement of their once-robust economy during most of the past 80 years. The current crisis again is mainly due to politicians who continued to borrow on the international capital market to finance large and growing budget deficits.

In 1991, to tame its tendency to finance public spending by printing pesos, Argentina introduced convertibility of its peso into dollars at a fixed one-to-one exchange rate. Hyperinflation was rampant in the 1970s and '80s, and prices increased by more than 1,000% in both 1989 and 1990. Monetary mischief and destructive government intervention reduced Argentina's economy to Third World levels, as its per-capita income sank from among the 10 highest in the world in the 1920s, to about 80th in 1990.

Convertibility controlled the issue of pesos and hyperinflation and stabilized the economy. By 1995, prices were rising at less than 2% per year. I, and many others, concluded that Argentina was on the path to sustained growth. But convertibility did not eliminate the tendency for the provincial and central governments to spend much more than they collected in taxes.

Spending by these governments grew to more than 30% of gross domestic product—a much bigger fraction than that of its neighbor Chile and a large share for a nation at Argentina's level of development with an ineffective tax system. These budget deficits were hidden during the first half of the 1990s by revenues from the sale of government companies.

After privatization revenue evaporated, the government financed the budget gap by borrowing dollars on the international market. In recent years, this debt grew to about \$150 billion as deficits exceeded 4% of the country's GDP. The deficits were financed mainly with dollar-denominated debt, and additional borrowing was needed just to pay interest and roll over expiring debt. When further borrowing became impossible, Argentina defaulted, ended convertibility of pesos into dollars, and froze most deposits at banks. The default will temporarily ease budgetary problems by eliminating interest payments from the budget and the need to refinance debt. The banking system is in shambles, and many depositors effectively have lost their savings.

Some critics blame Argentina's problems on the speed and extent of its free-market reforms inspired by the so-called neo-liberalism, or Chicago-style economics, of the early 1990s. However, Argentina did extremely well after 1991: Even

including the bad recent years, its real GDP to the devaluation grew by more than 4% a year. This beats Brazil's growth and that of other Latin American countries.

Argentina, however, did not reform its economy as much as its neighbor Chile, which is 17th, vs. Argentina's 39th position, on the index of economic freedom compiled by *The Wall Street Journal* and the Heritage Foundation. Argentina has higher trade barriers, more rigid labor markets with stronger unions, and a larger government sector than Chile, which has not experienced a major financial or economic crisis.

Others attribute Argentina's collapse to convertibility because the fixed exchange rate raised the cost of its goods on world markets. The dollar gained in value in the 1990s. Clearly, Argentina could have benefited by floating the peso earlier, perhaps in 1999, when Brazil devalued. However, I do not believe an overvalued peso was the major contributor to Argentina's economic difficulties. Exports account for only some 10% of the nation's GDP and rose as the dollar appreciated.

One recent Finance Minister, Ricardo Murphy, a former student of mine at the University of Chicago, lasted only 14 days before he tried to cut spending and raise taxes to close the budget gap. While printing more pesos and a little inflation will ease these budgetary problems, the end of convertibility will allow the government to return to its bad habits of financing spending with the printing press.

The International Monetary Fund and the U.S. should not rescue financial institutions financing bad Argentina debt. Indeed, the expectation of an international bailout probably encouraged lending that was not justified. Perhaps Argentina should receive aid after instituting reforms that reduce spending and improve the tax system, but the populist steps so far taken by recently appointed President Eduardo Duhalde are not encouraging. Nor is his record as Governor of Buenos Aires state from 1991-99; Duhalde ran large deficits and greatly expanded the payroll.

Violence and other protests continue to erupt as Argentines voice their displeasure with politicians. The nation is beginning to lose its most valuable asset—educated and skilled citizens. Emigration will turn from a trickle to a rapid flow, and those who remain will continue to stash billions abroad unless Argentina's central and provincial governments quickly get their financial houses in order.

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution.



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BY GENE KORETZ

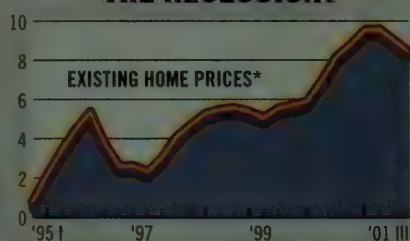
HOME, SWEET NEST EGG

Housing prices offset falling stocks

Remember the infamous "negative wealth effect"? Just as soaring stock prices purportedly induced households to spend wildly and stop saving during the boom, so the subsequent market debacle was supposed to touch off a sharp slowdown in consumption.

It never happened. Despite the onset

REAL ESTATE: WHERE'S THE RECESSION?



Data: Office of Federal Housing Enterprise Oversight

of recession and a \$4.2 trillion plunge in consumers' net worth in recent years, the savings rate remains low and consumer spending has stayed remarkably buoyant. The wealth effect, it seems, has lost its punch.

Or has it? According to Mark M. Zandi of Economy.com Inc., wealth shifts still have a big impact on consumption, but the rise in housing values seems to have largely offset the decline in stock market wealth. Economist Ian Morris of HSBC Securities Inc. agrees, noting that home resale prices, at last count, were up 8.4% year over year (chart).

Until recently, many experts doubted whether shifts in housing wealth can affect consumption as much as changes in financial wealth. Homeowners presumably have a harder time estimating the value of their houses than their stock portfolios. And many may not regard their homes as appropriate for funding current spending.

A recent National Bureau of Economic Research study by Karl E. Case, John M. Quigley, and Robert J. Shiller finds, however, that the wealth effect of real estate values has been seriously underestimated. Based on an analysis of annual data from 14 countries and quarterly data from a panel of U.S. states, the results suggest that the

housing market appears to be far "more important than the stock market in influencing consumption," both in the U.S. and other developed nations.

One likely reason for this in America is the concentration of stockholdings, with 10% of households owning more than three-quarters of all stocks. By contrast, more than two-thirds of U.S. households own homes, and many count them as their largest asset. And homeowners have been more willing to tap into the rising values of their homes, as mortgage refinancing and home-equity borrowing have become easier and more popular.

Much of the credit for today's buoyant housing market, of course, belongs to Alan Greenspan's interest-rate cuts. Now, with signs that rates may soon start trending higher, a key question is whether housing will falter in the months ahead. Zandi thinks any weakening will be limited. Morris, however, notes that strong price rises could turn into a bubble whose eventual bursting would undermine the recovery. If we're lucky, he says, "home prices will simply lose some steam as lagging sectors of the economy finally kick in."

THE TRUE VALUE IN VALUE STOCKS

How to find the real performers

Copious research has established that so-called value stocks, which have low prices relative to such variables as earnings or book value, tend as a group to consistently outperform both the overall market and glamour stocks with high price multiples.

In a study of some 14,000 value stocks (with prices running around 40% of book value) from 1976 to 1996, Joseph D. Piotroski, an accounting professor at the University of Chicago's Graduate School of Business, found that this superior performance is driven by just 25% or so of his sample. More than half the group trailed the market, according to the study, which appeared in a recent issue of *The Journal of Accounting Research*.

Could an assiduous investor identify prospective big winners? To find out, Piotroski constructed a "financial health" report card using information gleaned from corporate financial reports. He reports that value companies with positive grades on at least eight of nine variables relating to their financial conditions—such as trends in earnings, cash

flow, profit margins, and asset over—tended to outperform the market by 13 percentage points. That is, the period studied, portfolios composed of such companies (usually about 10% of value stocks) yielded one-year adjusted returns averaging 13.4%.

Piotroski concludes that value investors willing to pore over company financial statements could reap nice rewards—particularly in the smaller companies that are thinly traded and followed by few analysts.

HIGHER-UPS ARE GETTING THE AX

More security down the totem

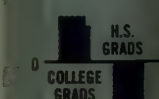
In economic downturns, it's the worst-paid groups, such as less educated workers, who are the first to lose their jobs. And, of course, they are the last to be rehired when the economy turns up. In the current recession, however, higher-earning groups appear to have suffered at least as much in relative terms as those toward the bottom of the income pole.

For example, recent Labor Department analysis found that employment in the highest-earning occupations—managers, professionals, and technical type—fell by about half a million between the third and fourth quarters of last year. Meanwhile, jobs in the bottom third of the income distribution, encompassing lower-paid, less-skilled jobs, declined by only 200,000. Indeed, economist Howard J. Vanecko of the Federal Reserve Bank of St. Louis notes that the unemployment rate among college grads—but not among less-educated workers—is now at its average 1994 level, before the last recession started (chart).

In sum, thus far the pain of lost jobs appears to have affected lower-wage workers less and higher-wage workers more than in past recessions. And with signs that a recovery may be at hand, that at least raises the hope that the ranks of the disadvantaged may be able to weather the current economic storm better than many observers have feared.

VULNERABLE COLLEGE GRADS

CHANGE IN JOBLESS RATE 1994 TO 1997



▲ PERCENTAGE POINT DIFFERENCE

Data: Labor Dept.

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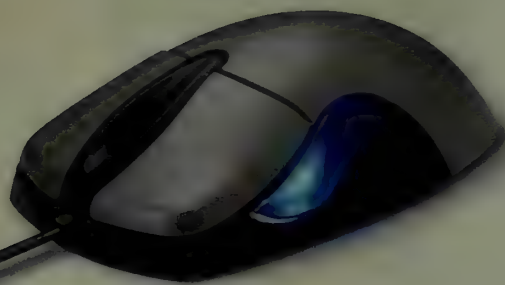
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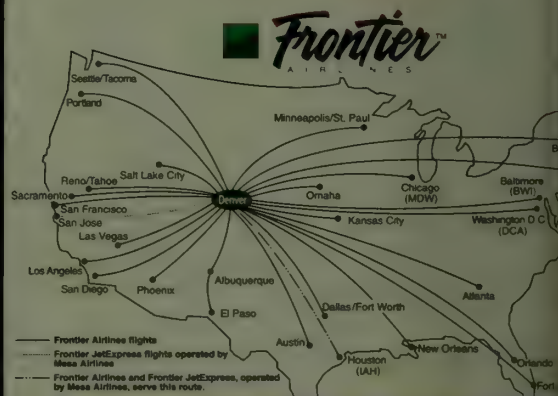
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AMES C. COOPER & KATHLEEN MADIGAN

ONCE AGAIN, THIS ECONOMY SHOWS AN UNEXPECTED RESILIENCE

vertheless, a shallow recession may beget a shallow recovery

U.S. ECONOMY

The Jan. 30 report on fourth-quarter gross domestic product—with its unexpected gain in output—highlighted an interesting fact that could be easily missed: how quickly the U.S. economy has moved beyond the tragedies of September 11.

Immediately after the attacks, the feeling was that businesses would have to build up inventories as a hedge against supply disruptions: Just-in-time inventory management would become just-in-case. And consumers were so stunned that they would stop spending. Instead, the fourth-quarter mix of shrinking inventories and soaring demand shows how fundamentally sound the economy is (chart). That view is supported by the latest monthly data which show that consumers are increasingly confident about the economy's future, housing just finished its best year ever. Even orders for capital goods seem to have turned the corner, especially those for high-tech gear. Firm demand and need to rebuild inventories after a year of unprecedented liquidation means this recession is over.

DISCONNECT BETWEEN INVENTORIES AND SALES



RECENT CHANGE FROM 2-YEAR AVERAGE
Data: Commerce Dept., DRI-WEFA

According to the Commerce Dept.'s report, real GDP edged up at a 0.2% annual rate in the fourth quarter. While the gain was small and could turn into a negative when Commerce revises the GDP data, economists had expected a drop in the neighborhood of 1% following the 1.3% contraction in the third quarter. The surprise pop in GDP growth suggests that when the National Bureau of Economic Research sits down a few months from now to determine the economy's trough, the end date of the recession may well be this past December or January. The gain also explains why the Federal Reserve chose to hold interest rates steady at its Jan. 29-30 meeting. Interestingly, the yearend increase raises questions about whether the economy really slipped into recession in 2001 (page 32).

THE VERY LEAST, the fourth-quarter gain means a downturn will probably turn out to be one of the most superficial slumps in the postwar era. From the third quarter of 2001 to the fourth quarter, the peak-to-trough decline in real GDP was a tiny 0.3%, vs. the

2.2% average for all postwar downturns. Only the 1969-1970 downturn, when output slipped just 0.1%, was more shallow.

Bear in mind, however, that shallow recessions beget mild recoveries. Although inventory growth is set to turn around, businesses and consumers are adjusting to the new realities of diminished expectations, compared with the high-flying days of the late 1990s. In particular, many service industries, such as advertising and financial services, will be slow to get back up to speed. Companies still have a lot of excess production capacity left over from past overinvestment. And households are not going to enjoy the same boosts from stock prices and house values that they had been.

Economists were downbeat on real GDP growth because the monthly data showed that inventories were being liquidated at a phenomenal rate. And in fact, inventories fell at a record \$120-billion pace last quarter. But that was offset by increased spending by consumers, government, and businesses. Domestic demand grew at a 2.5% annual rate last quarter, boosted by a 3.6% surge in consumer spending, as shoppers flocked to car dealerships after Detroit introduced its generous financing deals.

That wasn't supposed to happen. Fear of terrorism was expected to keep shoppers at home. But consumers seemed to shrug off uncertainty. That was especially clear in the yearend trend in home sales. Consumers showed great willingness to take on the huge financial commitment of paying off a mortgage. December sales of new homes rose 5.7% to an annual rate of 946,000. Sales of new houses set a record of 901,000 for all of 2001.

THE QUESTION IS WHETHER consumers' resilience will continue in 2002. So far, the data are encouraging. Weekly surveys show that retail sales are rising sharply from their December level. And although Detroit scaled back its incentive plans, car sales are reported to be holding up well in January.

Even so, consumer spending is unlikely to match its fourth-quarter surge. At the very least, vehicle sales in the first quarter will likely be well below the 18.4 million annual rate for the fourth quarter. That drag will

THE FUTURE LOOKS MORE ENCOURAGING



Data: Conference Board

Business Outlook

offset gains in other consumer buying. If large enough, the drop could even lead to a decline in quarterly household purchases for the first time in 10 years.

The Fed, however, has concluded the economy's prospects have picked up. That's why the Fed left the federal funds rate unchanged at 1.75% at its Jan. 29-30 meeting. In its statement, it said: "Signs that weakness in demand is abating and economic activity is beginning to firm have become more prevalent." The statement's upbeat tone paralleled a Jan. 24 speech by Fed Chairman Alan Greenspan in which he clarified his hopes for the outlook. With the recession's demise, this Fed policy-easing cycle appears to be over as well.

EVEN BEFORE THE GDP DATA, consumers were expressing a brighter view of the economy. The Conference Board's index of consumer confidence edged up in January to 97.3, from 94.6 in December. All of the gain was in expectations for the future. That index jumped from 92.4 to 96.9, the highest reading since December, 2000 (chart, page 29).

Better job prospects are driving sentiment. In January, 18.8% of consumers thought jobs will be more plentiful in the next six months, up from 16.5% in December. The recent trend in jobless claims supports that view. Filings for jobless benefits spiked after the September 11 attacks but are now down sharply.

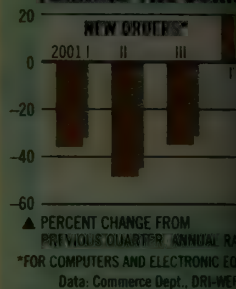
Surprisingly, though, consumers aren't the only ones

feeling better about the economy. Business executives are showing their confidence through their spending plans. Durable goods orders rose by a better-than-expected 2% in December, and new orders for nondefense capital goods—a proxy for business sentiment—increased 1.3%, their third consecutive advance.

Demand was particularly strong for computers and related electronics. The GDP report showed that outlays for information processing equipment posted the first increase in a year, and looking ahead, new bookings for high-tech gear grew at an annual rate of 20.1% in the fourth quarter, the first increase in 1½ years (chart). A steady increase for computer demand suggests the tech meltdown is coming less of a drag on the economy. And make computers, semiconductors, and peripherals may be gearing up production plans.

That's far different from what most economists expected only a few months ago. Indeed, the behavior of businesses and consumers is once again a testament to the new flexibility of the U.S. economy, a characteristic that it has shown many times in the face of adversity during the past decade.

HIGH-TECH DEMAND TURNING THE CORNER



BRAZIL

ELECTION-YEAR POLITICS COULD SLOW PROGRESS

On Jan. 15, 2002, Brazil began its fourth year with a free-floating currency. The move, coupled with the government's inflation targeting system, has been a clear success. Indeed, the economy's flexibility helped it to weather a barrage of challenges in 2001. Still, the country faces significant risks.

Even amid global weakness, the September 11 terrorist attacks on the U.S., Argentina's meltdown, and an energy crisis that caused power rationing, Brazil's economy appears to have grown about 2% in 2001 with 7.7% inflation. Moreover, Brazil posted a trade surplus, the first since 1994, and toward the end of the year, the currency ral-

lied strongly, although it has relinquished some of those gains in recent weeks.

The economy begins 2002 with two key—but possibly opposing—goals: continued trade improve-

ment, which will require restraint in domestic spending, and political stability in a presidential election year. Trade gains will have to continue in order for Brazil to cut its dependency on scarcer foreign capital. And the government must avoid eas-

ing fiscal policy ahead of the elections, while promoting a smooth transition of power.

Given recent signs that the U.S. economy is set to lead a global pickup, Brazil's growth outlook is improving. But gains may be halting in the first half. The central bank will not be quick to lower interest rates, currently at 19%, because of badly missing its 4% inflation target for 2001. The goal for 2002 is 3.5%.

As a result, consumer and business demand is soft. Consumer confidence rebounded in January but employment is not improving and inflation is cutting into purchasing power. December retail sales and industrial production looked tepid, and capacity utilization is the lowest in two years, suggesting little incentive to lift capital spending.

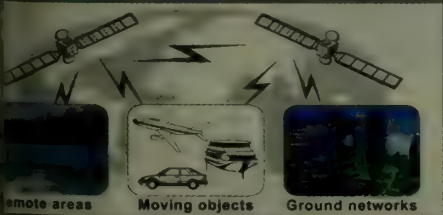
Economists expect inflation to decline, allowing the central bank to trim rates and bolster growth. But the October elections will be crucial. Lower rates and a stable currency could lie in the balance.

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WHAT RECESSION?

The fast-changing economy is more robust than many expected

Can it be true? The economy actually grew 0.2% in the final quarter of 2001. That means the recession that officially began in March still hasn't produced two quarterly declines in real gross domestic product. So is it a recession or isn't it? And what does this surprising report mean for the outlook?

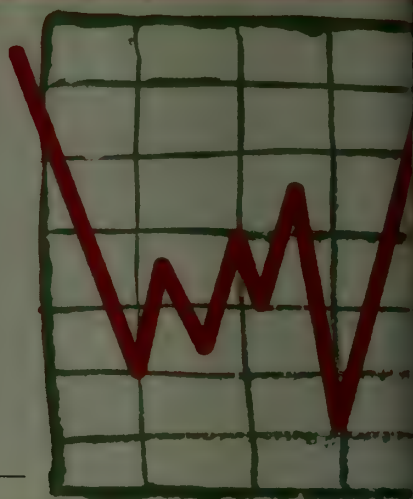
Preliminary GDP data are always subject to revision, but details of the Commerce Dept.'s Jan. 30 report make two key points that are unlikely to be revised away. First, if the U.S. was in recession, it's probably over and a gradual recovery has already begun. Second, the National Bureau of Economic Research (NBER) may need to rethink its methodology for determining recessions and recoveries. Those guidelines haven't kept up with a rapidly changing economy where productivity creates the bulk of output gains and services make up the lion's share of GDP.

Another inescapable conclusion from the report: overall demand in the U.S. remains amazingly resilient, even after September 11 (page 29). Consumer spending last quarter, lifted by a surge in car sales, rose at a 5.4% annual rate—a remarkable showing, recession or not. And the strength continues in 2002. "Everything is in place for a pickup in the economy," says retail analyst Linda T. Kristiansen at UBS Warburg, who

thinks sales will improve into the fall. Many businesses also appear to be taking a second look at capital-spending plans. Outlays for high-tech equipment rose last quarter for the first time in a year, and orders for computer equipment jumped at a 20% annual rate. The war against terrorism also temporarily boosted government outlays at all levels. That will continue, albeit more slowly.

The big plus for the economy is that all this extra spending generated a record drawdown of inventories. Businesses liquidated their stockpiles at an annual rate of \$120 billion last quarter, as great as the pace of the first three quarters of 2001 put together. That left store shelves and dealers' lots so bare that businesses will have little choice but to ramp up their output this quarter. Auto makers are "coming around to the conclusion that 'hey, sales are better than we expected—inventories are too low, let's increase our [production] schedules a bit,'" says auto analyst David Healy at Burnham Securities Inc. As a result, most economists are scrambling to put a plus sign on their first-quarter GDP forecasts.

Forecasters at the Federal Reserve are expecting real GDP to grow 1% to 2% this quarter. The Fed left interest rates unchanged at its Jan. 30 policy meeting and hinted that this cycle of policy easing is now finished. The Fed's statement implies that policymakers believe the worst is over and that long-run

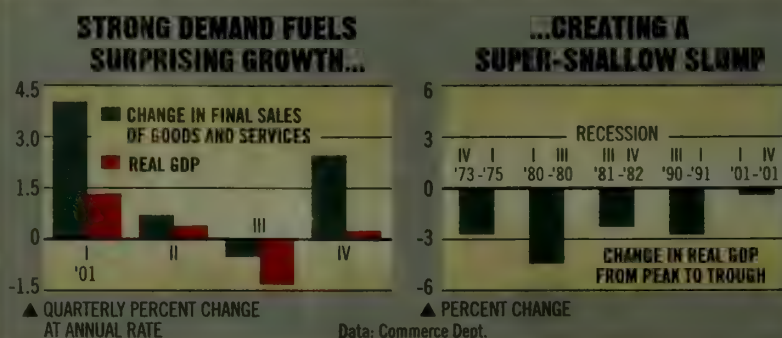


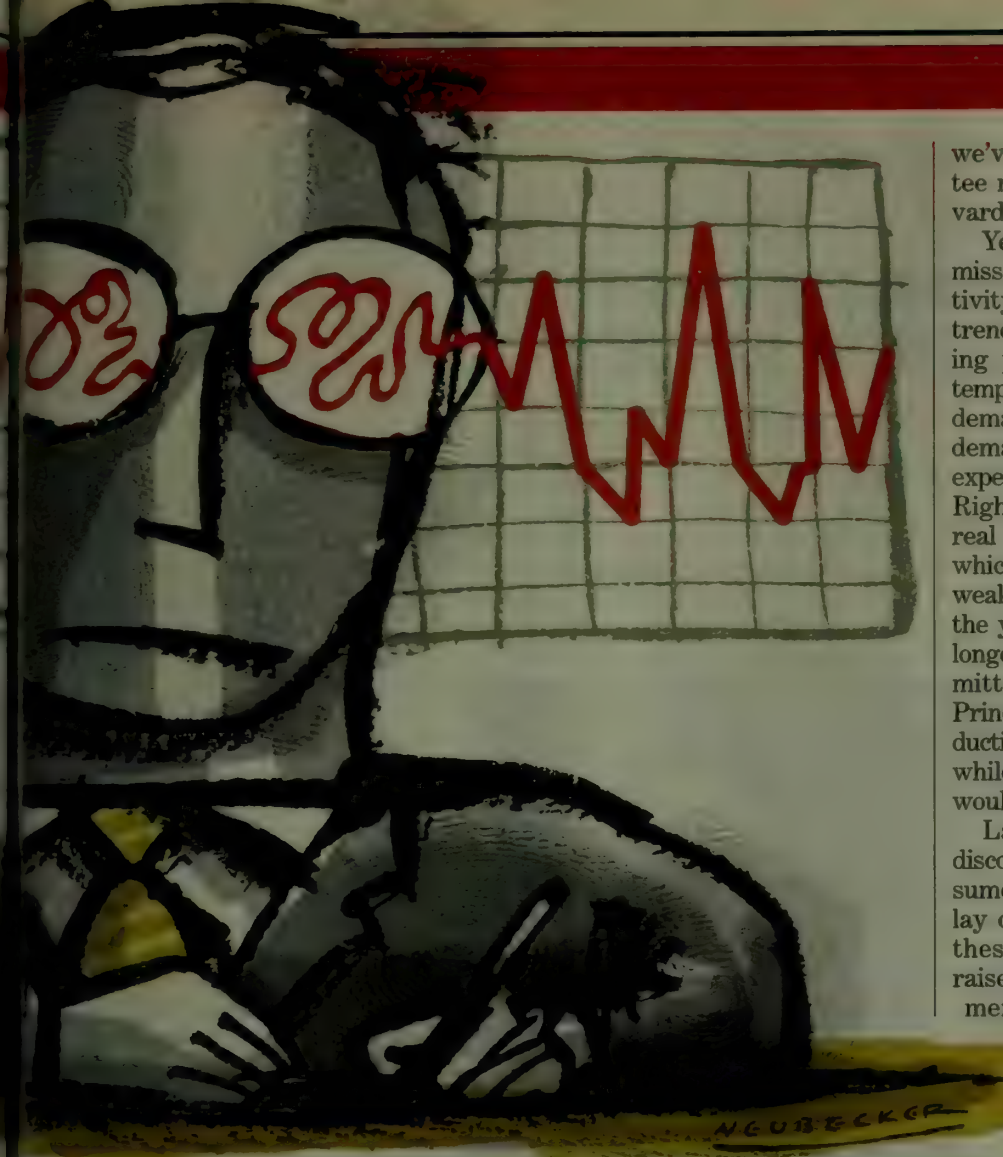
prospects for productivity growth remain favorable. Indeed, the GDP suggests that productivity increased 3% or so annual rate in the fourth quarter, a stunning performance during recession.

So much for the good news. The news is that the fourth-quarter surprise raises some fundamental questions whether the U.S. is determining business cycle correctly. True, the economy was hurting in 2001. More than 1 million people have lost their jobs since March, and manufacturing saw its slump since the Depression. But it appears the NBER's Business Cycle Dating Committee—the academics who declare the cycle's peaks and troughs

was too arbitrary, saying the economy was in recession in March.

That's no small dilemma. An official declaration of a recession has unintended consequences. Indeed, President Bush made a habit of referring to the recession when he pushed his stimulus plan through his State of the Union





we've made a mistake," says committee member Jeffrey A. Frankel of Harvard University.

Yet the NBER's reliance on job data misses the fact that U.S. business activity is shaped by two new powerful trends: the push to boost output by lifting productivity and a greater use of temporary workers to adjust to swings in demand. The combination means that as demand growth fluctuates, payrolls will experience wider swings than in the past. Right now economists expect first-half real GDP to grow by 2%, for example, which means the labor markets will be weak until late summer. If job growth is the yardstick, this recession could be the longest in the postwar era. Indeed, committee member Ben S. Bernanke of Princeton University agrees that if productivity is strong, output could rise even while employment falls. "The question would be: Is that a recession?" he says.

Labor's new flexibility has caused a disconnect between job growth and consumer demand. Companies can quickly lay off temps when demand slows. But these same businesses can give real raises to their remaining workers commensurate with faster productivity.

This divergence was evident in 2001. Unemployment has risen by about two percentage points in the past year, but real wages are growing at the

CHANGE Two powerful new trends are shaping U.S. business: The push to boost productivity and greater reliance on temp workers

With the recovery already under way, the government risks overstimulating the economy. Worse, companies may delay ordering if they think the economy is in the tank. The danger is poor business decisions will be made. Swings in economic activity are overblown. Ultimately, those mistakes could lay upon themselves and cause a mild recovery to spiral into a severe downturn. At high stakes of declaring a recession is why economists are careful to use a strict definition that does not include the GDP. A recession, they say, is a significant decline in activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income, and the sale-retail trade." By that metric, the economy may not have weakened sufficiently or broadly enough to qualify. It was clear prior to the September 11 attacks, a point that the NBER has admitted. And now, the GDP raises questions about the depth

of the weakness after September 11.

So why did the NBER go all the way back to March to mark the recession's start? That's when payrolls peaked. The NBER's other three measures of economic activity don't support a March start date. Industrial production has been falling since October, 2000. Except for an attack-related drop in September, business sales have been about flat since late 2000. And real incomes are still growing solidly.

When all that data is blended together—as it is in the index of coincident indicators, which tracks the economy's current performance—they suggest the economy held its own until August. That's when the index began a four-month drop that was exacerbated by the September 11 attacks. The coincident index suggests the recession didn't start until the third quarter. Nevertheless, the NBER committee remains comfortable with its decision. "Nothing that's happened would cause us to think

fastest pace since the 1960s. The high-productivity lift to wages explains why demand has stayed strong even in a slack labor market.

The NBER would benefit enormously from higher-quality data that better reflect the New Economy. But until that happens, at a minimum the NBER should recognize the structural shift in the labor markets by giving more weight to the real-income numbers. It ought to deemphasize U.S. factory data further. Manufacturing is only 16% of the economy. With global producers satisfying a greater share of U.S. demand, industrial production is too narrow a gauge for the overall economy's health.

Despite the questions raised about the recession, the fourth-quarter GDP report was excellent news. Even better, growth is likely to remain in positive territory for all of 2002.

By James C. Cooper and Kathleen Madigan in New York, with Rich Miller in Washington and bureau reports

COMMENTARY

By Lee Walczak and Richard S. Dunham

CAN THE DEMOCRATS PROFIT FROM THE RETURN OF DEFICITS?

Once upon a time, Republicans were the dour guardians of budget discipline. Democrats rooted blissfully at the federal trough while they hummed *Happy Days Are Here Again*. But where are those happy profligates of yesteryear? Intent on indicting Bushonomics for the return of budget deficits, they're marching toward Election '02 as staid and sober as a pack of actuaries. The party's new theme: *Stormy Weather*.

That will be a tough stance to maintain in light of the latest gross domestic product report, which shows that the economy has shaken off the slump. Indeed, in his Jan. 29 State of the Union address, President Bush described the return of the red ink as a "small and short-term" problem. Democrats gave him a respectful hearing, as befits a leader boasting an 84% approval rating. But the gloves will come off on Feb. 4 when the White House unveils a 2003 budget with a \$100 billion shortfall.

To Democrats, the return of deficits a year after the Congressional Budget Office forecast a \$5.6 trillion surplus over the decade serves as proof of Bush's fiscal failure—and recovery or not, it will frame the party's assault in November. "Republicans created a fiscal mess and are endangering long-term growth," says Democratic pollster Stanley B. Greenberg.

The Dems' complex argument goes something like this: While the GOP claims the deficit is cyclical and will vanish when strong growth resumes, Democrats hint that the U.S. may be facing structural deficits. The cause? Bush's big tax cut, which could end up costing \$2 trillion if it becomes

permanent and interest costs are added in. The current CBO surplus projection for the period: \$1.6 trillion.

The President believes that trims in marginal tax rates are growth enhancers, and with unemployment likely to rise for many months, he still thinks stimulus is needed. So he continues to back plans for a \$100



2003 budget with a \$100 billion shortfall, the Dems will come out swinging

GEORGE W. BUSH DELIVERING HIS FIRST STATE OF THE UNION ADDRESS

billion jolt. But as pols sense the slowdown may be over, odds for a big package fade.

Even if tax revenues rebound next year, Dems fear that Bush's tax-rate cuts will not be a supply-side growth elixir. Instead, the specter of shrinking surpluses could push up interest rates and crimp economic growth. And in an ensuing crunch, they fret, tax cuts could crowd out spending on schools, health care and the like. "Market rates didn't come down at all last year despite 11 Federal Reserve rate cuts," says former Clinton Treasury Secretary Robert E. Rubin, now chairman of the executive committee at Citigroup. One reason: "The deterioration in our [long-term] fiscal

situation." But Rubin concedes Democrats are having trouble making this argument. "It is very, very hard" to explain, he laments.

While Democrats radiate Mondri-style pessimism, Republicans are models of Reaganesque optimism. "In past recessions, deficits ranged from 2% to 4% of gross domestic product," chirps Budget Director Mitch Daniels. "This time, it's well under 1%. The ink is red, but just barely." Besides, add conservative economists, small deficits are meaningless. Says Dan Mitchell, an analyst at the Heritage Foundation: "In a \$10 trillion economy, blips in deficits or government spending are insignificant."

According to American Enterprise Institute economist John H. Makin, Republicans now see deficits as a product of the need to run a more stimulative policy during a slump. "In the '90s, there was this notion that low deficits equal high growth," he says. "Now we see that government needs to run more like a corporation, issuing debt during a downturn." To Makin, the turnabout is stark: "Democrats are turning into old-fogie Republicans, warning about deficits and anemic growth."

Fogies or not, the Dems still have

PLAN OF ATTACK

When Bush unveils

to make deficits scary. A Jan. 17-18 ABC News.com poll found that by 52% to 32%, Americans would demand tax cuts to keep the budget in balance. But overall, Bush, with his ger megaphone and some economic stats going his way, seems to be winning this debate. In a Jan. 24 Gallup Poll, voters favored his economic stewardship over the Democrats' by 55% to 36%.

The bottom line for Democrats is that they may need a bout of economic malaise to get traction on the fiscal mismanagement issue. But if recovery signs are blossoming, the prospects for a campaign built around pessimism don't look bright.

With Rich Miller in Washington

COMMENTARY

By Nanette Byrnes

PAYING FOR THE SINS OF ENRON

If there was any question that accounting malfeasance is at the top of the national agenda, it was settled on Jan. 29. That's when President George W. Bush strayed from the usual litany of Medicare-funding and defense-budget demands to appeal for accounting reform. That's right, accounting reform. Questions about the quality of audited numbers have grown so pervasive so quickly that they now merit prominent placement in the State of the Union address.

It's a remarkable about-face from the not-so-distant carefree days of Henry Blodget, momentum investing, and the impassioned defense of pro-forma earnings calculated at management whim. In those heady times, investors were willing to believe even the most farfetched valuations.

Then came Enron Corp. The collapse of the New Economy highflier ended the blind optimism that had leaked with the dot-com

razor. Today, there's a new sobriety on Wall Street—and a new era in which earnings and valuations will be lower and momentum may lead to reform. Today's hot stock? Not tech giant Cisco Systems Inc., which at 19 a share is less than half its 52-week high, but steel-maker Nucor Corp., which is topping its highs at 57 a share.

In a 180-degree turn, Wall Street has become as harsh a judge as it was once lenient. As Enron imploded, investors realized they had never really understood how the company made its money. Since then, they have been exacting swift retribution, hammering any company bearing the slightest whiff of financial chicanery. "It's the reverse of the old bank crisis," says

Patrick S. McGurn, vice-president of Institutional Shareholder Services. "It's not a run on the bank. It's a run out of stocks."

And it's not just the outliers that are suffering. Blue chips are also getting a shellacking for practices that a year ago would have been greeted with yawns. Among the companies that have succumbed to Enronitis: Tyco, Cendant, AOL Time Warner, even Disney.

Pipeline owner Williams Cos. fell 22% Jan. 29 after announcing a delay of its fourth-quarter earnings pending the review of \$2.4 billion related to an April spin-off. PNC Financial Services

Group Inc. shares fell 9% the same day after divulging that federal regulators sought changes in its accounting for off-balance sheet vehicles. Cendant Corp. dropped 10% on Jan. 29 on rumors that a newspaper article critical of its accounting was in the works. "This is the biggest crisis investors have had since 1929," says watchdog Howard M. Schilit, who is seeing new demand for the research done by his Center for Financial

Research & Analysis. "Investors don't know who they can trust."

Among the hardest hit are the conglomerates, once beloved by Wall Street for their fast and steady

growth. Just this year, some \$50 billion of Tyco International Ltd.'s market value has evaporated after investors panicked over the company's less-than-crystal-clear financials. Even the master conglomerateur, General Electric Co., has not been able to avoid a stock decline this week. While investors love GE's steady results, they're

getting cold feet over its opaque financials. "People have become fearful of complex accounting," says Matt Greenberg of Iridian Asset Management LLC, a Tyco shareholder.

That has led to a new sport on Wall Street: ferreting out the next Enron. McGurn of ISS notes that Wall Street analysts looking to make a name for themselves are now hunting for the next big blowup, not the next hot stock. Robert Uek, a portfolio manager at John Hancock Funds and a former certified public accountant, says he and his staff are combing through the financials of every stock they own. And led by big union funds, investors are planning 36 proxy initiatives at companies such as Walt Disney Co. proposing that auditors be barred from consulting.

When will it all end? Probably no time soon. TIAA CREF retirement fund Chairman John H. Biggs says that investors should expect far lower earnings this year as internal and

external auditors scrub down the numbers. "Confidence has been shaken," says Gerald I. White of institutional investor Grace & White Inc.

"And it's a lot bigger than Andersen and Enron."

Byrnes, who was assisted by bureau reports, covers accounting from New York.

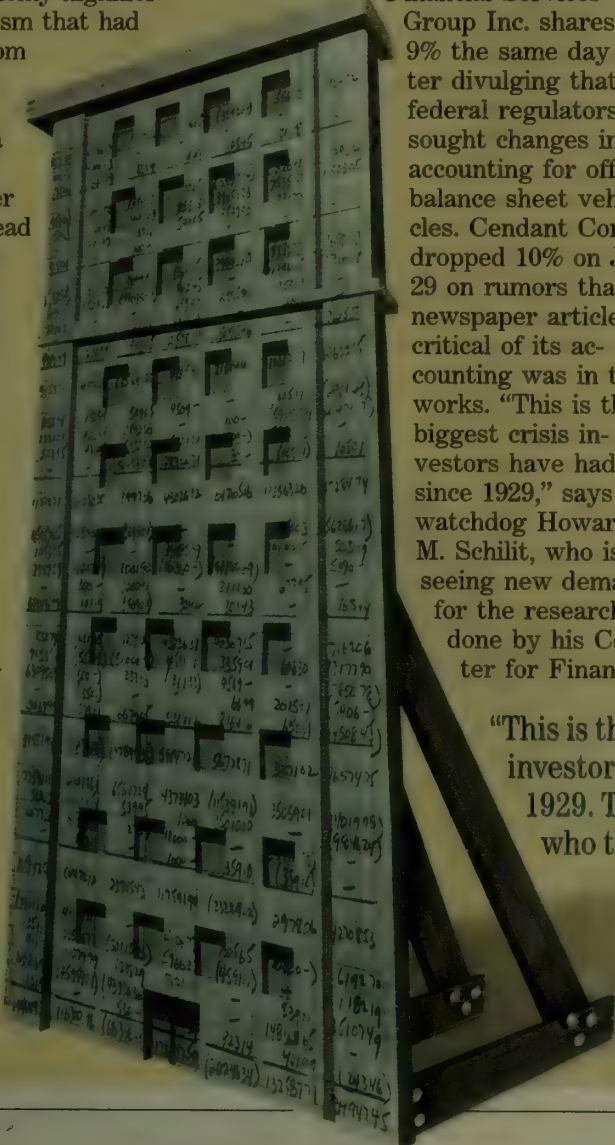
ENRONITIS

Investors flee as fears of accounting woes spread

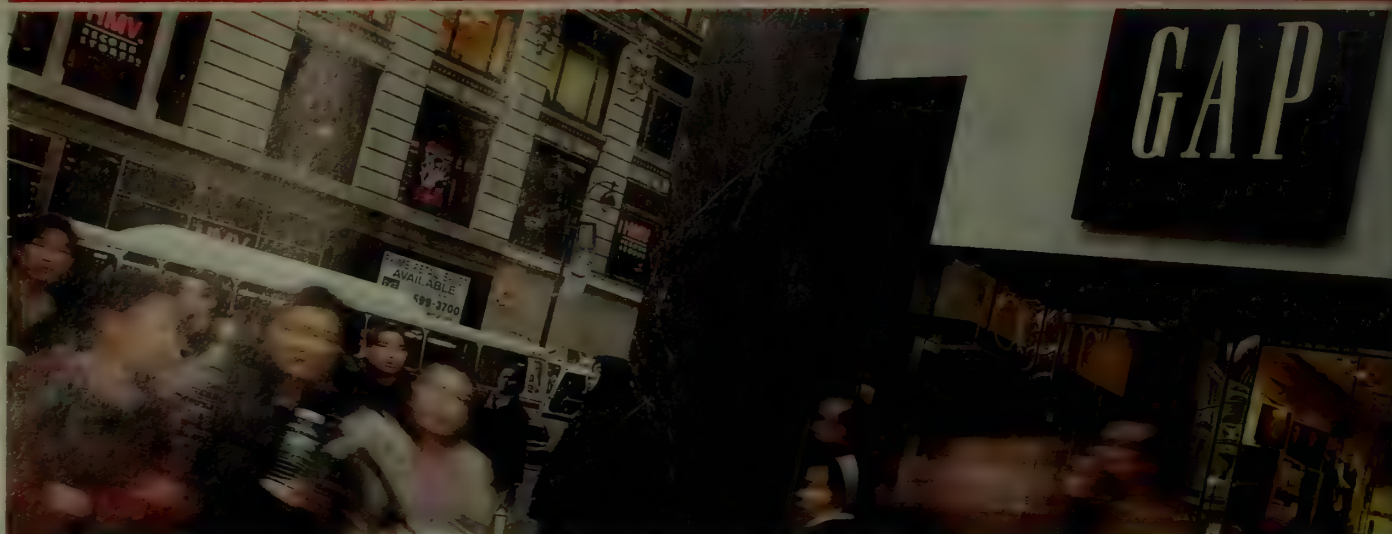
STOCK DECLINE 1/23-1/30/02

TYCO	-26%
WILLIAMS	-23
CENDANT	-17
AOL TIME WARNER	-7
GENERAL ELECTRIC	-4

Data: Bloomberg Financial Markets



"This is the biggest crisis investors have had since 1929. They don't know who they can trust"



RETAIL

MORE THAN JUST A BAD PATCH AT GAP

Rising debt and a falling credit rating are taking a toll

For the past couple of years, critics have lambasted Gap Inc. for its lousy fashion sense. But the naysayers may soon have something else to focus on: a balance sheet that's becoming increasingly threadbare.

The next two quarters will be critical for Gap. While no one yet expects the San Francisco-based specialty chain to file for Chapter 11 bankruptcy, as Kmart Corp. just did, there are enough red flags popping up—credit downgrades, increasing debt, and upcoming talks with nervous bankers—to heighten uncertainty about Gap's future. Says Conor D. Reilly, a bankruptcy partner at Gibson, Dunn & Crutcher: "If you asked everybody who follows retail to name five companies that could have serious problems in the next six months, I'd be shocked if Gap wasn't on the list."

CEO Millard Drexler has long expressed confidence that Gap will get back on the right merchandising track, which would do much to ease its financial ills. But Gap's holiday selling season was disastrous: Sales at stores open at least a year fell 11% in December compared with a year ago—when the chain's stores posted a 6% drop. Indeed, Gap has been posting declines every month since April, 2000. Meanwhile, an ambitious expansion plan and long-term store leases had made it hard to cut costs. The result: Analysts project a fiscal 2001

net loss of \$22 million on \$14 billion in sales, versus \$877 million in profits last year on sales of \$13.6 billion. That dismal performance has sent Gap's stock, which fell 57% in the past year, reeling.

To add to the gloom, Gap's long-term debt has ballooned from \$780 million to \$2 billion in the past year. Much of that was for new stores, but a big chunk—\$700 million—was to refinance commercial paper. Gap's commercial paper was later downgraded, effectively shutting it out of that market. In the first three quarters of fiscal 2001, interest costs rose 60%, year-to-year, to \$77 million. Like most retailers, Gap also carries off-balance sheet lease obligations. They total \$5.5 billion through 2025. On Jan. 14, Moody's Investors Service downgraded Gap's long-term debt, to just above junk status.

That poor credit rating will make it tough to renegotiate a \$1.3 billion bank credit line that matures in June. Without access to commercial paper, that credit line is crucial, but the bankers will be wary. "Now that Kmart has filed for Chapter 11, our concern is about the appetite that banks have to provide retailers in general with large credit facilities," says Moody's analyst Elaine E. Francolino.

Other measures of Gap's creditworthiness have also deteriorated. Its ratio of EBITDA (earnings before interest, taxes, depreciation, and amortization) to interest payments, a measure of how easily a company can cover those payments, was 5.4 last November—down

from 8.3 a year earlier. Gap has \$800 million in cash on hand, but as of the end of the third quarter it wasn't generating enough cash to finance operations and pare debt. Treasurer Sabrina Simmons says free cash flow in the fourth quarter will be positive, partly because Gap is turning back on store openings.

Gap's expansion is a sore spot for credit analysts. Over the past few years, Gap added square footage at a rate of 13% to 31% a year and is piling on additional 5% this year. "Who in their right mind would have expanded the Gap in the face of such terrible

MORE STORES
Recent expansion has become a sore point

results?" asks Howard Davidowitz, chairman of retail consulting firm Davidowitz Associates Inc. Gap may be caught around. It says it signed no new leases beyond 2002.

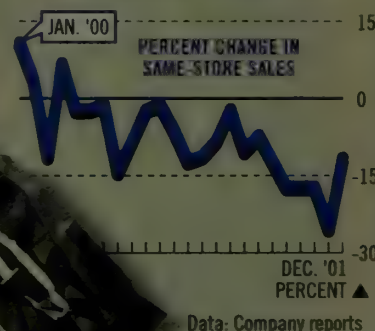
So what's the case scenario? Bankers, including Fleet National Bank and Wells Fargo (which either

return calls or declined to commit) will refinance its facility, but with higher interest rates or covenant restrictions that could include securing the line with inventory. "They'll have to give up something," says Gerald Hirschberg, analyst at Standard & Poor's. Simmons acknowledges that terms for new credit will likely be harsher.

And as for the worst case? That's something Gap doesn't want even think about.

By Louise Lee in San Mateo
Nanette Byrnes in New York

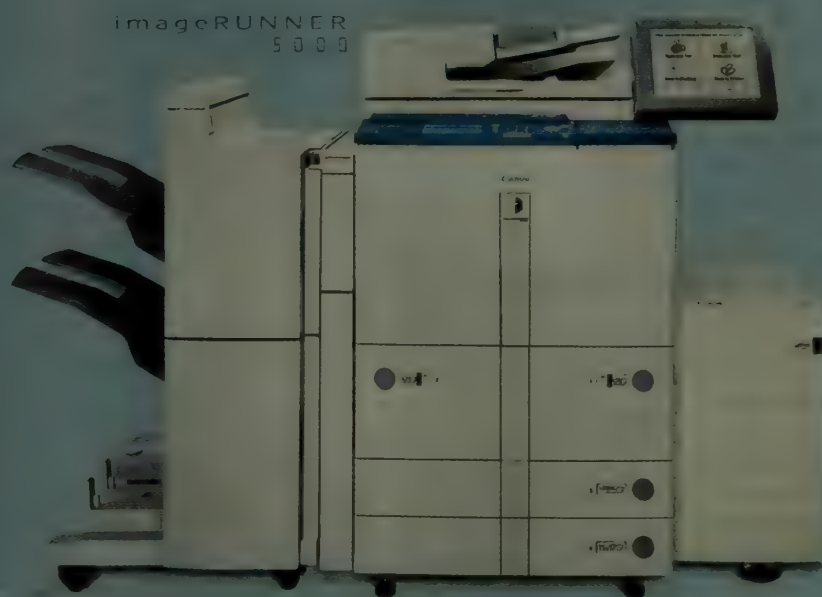
GAP'S LOSING STREAK



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INVESTIGATIONS

JEFF SKILLING: ENRON'S MISSING MAN

The CEO who created its in-your-face culture has been largely absent from the inquiry

Former Enron CEO Jeffrey K. Skilling was never known for his subtlety. Just ask Joe Barton. A Republican congressman from Texas, Barton has long been friendly to energy companies. And as head of the House energy and air quality subcommittee, he was in perfect position last year to help Enron Corp. in its quest to open state electricity markets to competition. But when Barton struck a deal that he thought was fair, allowing states to set their own timetable without threatening federal preemption, he soon found that Enron—which donated \$28,909 to Barton since 1989—had something else in mind.

Accompanied by Enron lobbyists, Skilling demanded to know why Barton had not insisted on a fixed date for states to deregulate. "He didn't like that and proceeded to tell me how I should run my subcommittee," Barton recalls. "I told him he could run his company the way he wanted and I would run my subcommittee the way I wanted."

Now, Washington wants another crack at Jeff Skilling, the mystery man at the center of the Enron scandal. He was the architect of Enron's strategy and of much of the financial underpinnings. And his abrupt Aug. 14 resignation prompted many outsiders and even an inside whistleblower to conclude for the first time that something must be terribly wrong with Enron.

Investigators in Congress are curious as to just how the brilliant and intimidating Skilling ran his company—and whether he orchestrated the accounting scandal that brought down the nation's biggest energy trader. The Senate Commerce Committee tried twice to get him to testify at its Feb. 4 hearing. His ex-boss, Chairman Kenneth L. Lay, is set to testify then about his role. Lay's wife and children have appeared on TV, portraying him as a victim. So far, Skilling has indicated to the committee that he will possibly talk at some point, but not on Feb. 4. He declined to comment for this story.

But even if Skilling doesn't answer the Senate's questions, he'll have a hard time escaping the spotlight. By nearly all accounts, Skilling, 48, was Enron's chief visionary, head cheerleader, and internal compass. He created and embodied the in-your-face Enron culture,

where risk-taking, deal-making "thinking outside the box" were rewarded, while controls appeared at best. The question is, did he implicitly or explicitly push subordinates to break laws as a heavily indebted company scrambled to hide years of bad in-

JEFF SKILLING'S RISE AT ENRON...

- ▶ A hotshot McKinsey consultant, Skilling caught the eye of Enron CEO Ken Lay by creating new energy-trading products.
- ▶ He became the architect of Enron's "asset-light" strategy, insisting that its trading model could be applied to many different markets.
- ▶ He was the foremost advocate of energy deregulation, pushing states to open their electricity markets.

...AND THE QUESTIONS HE LEFT BEHIND

- ▶ Why did he quit? Skilling insists he left in August for "personal reasons" and that Enron was in great shape. But the company's finances began to unravel shortly afterward.
- ▶ How much did he know about Enron's off-balance-sheet partnerships? Skilling says that while he approved their creation, he was surprised by how much money some of the company's financial executives made on them.
- ▶ Did he know Enron was headed for a fall? Skilling had already reorganized the retail energy unit, which some former employees say was manipulating the way it valued contracts to beef up Enron's earnings.

to keep its crucial credit rating? Enron was presented externally as a well-organized organization, but there was never a question who was in charge," says a former Enron trader. "It was Jeff."

Former colleagues are divided over how much Skilling knew about Enron's mounting financial troubles before his surprise exit. Some insist there was no concerted effort to mislead investors, but a company trying to push bold new ideas are now being misconstrued. One former exec recalls that last June, Skilling was talking about leaving in a few years and showed no sign of concerns.

Now, an embattled Skilling is fending off lawsuits from a new, \$4 million Houston mansion

Did he push subordinates to break laws as a heavily indebted Enron scrambled to hide years of bad investments?

where he can track commodity prices on ceiling screens. He has insisted that Enron was in great shape when he left for undisclosed personal reasons and that he wasn't warned of any accounting improprieties. But even those who are reluctant to attribute sinister motives to the former McKinsey & Co. consultant paint an unflattering portrait. Skilling "was a brilliant strategist and a terrible manager" who surrounded himself with "yes men," says a high-level Enron exec. A veteran analyst says the impulsive, immature Skilling—who once called a hedge fund manager an "a--hole" on a conference call—was simply a poor choice for CEO: "He didn't provide the kind of balance wheel so necessary for a CEO. Someone has to say no."

That's the generous view. Sources close to a Securities & Exchange Commission probe say they're skeptical that underlings could have concealed wrongdoing from such a hands-on manager as Skilling, who regularly walked the halls and talked to employees. A more damning picture is gaining currency among critics as a growing number of ex-employees describe a rogue

company that seemingly created earnings from thin air in unit after unit. The off-balance-sheet partnerships that triggered Enron's collapse, in this view, were just a symptom of a company determined to pump up its stock and make earnings at any price. "Everyone knew that the company was a house of cards and that it was overvalued," says an ex-manager at Enron's Azurix Corp. water-services unit. "I just figured—and I think most people did—that if they were getting away with it now, they will get away with it forever."

Under Skilling, Enron's performance-review and compensation systems were lauded by management gurus for fostering creativity. Now, they're being excoriated for promoting greed and financial

impropriety at the expense of long-term shareholder value. Ex-employees say bonuses and good reviews were based on doing deals—the more and bigger, the better. Often, the estimated profits numbers attached to a deal bore little resemblance to

the reality of the profits Enron would reap, former employees say. Under Skilling's philosophy of shedding assets and valuing "intellectual capital," those who pitched the next deal were the heroes; those who worried about creating solid assets for the next decade "wore a scarlet A" and were marginalized, says a former manager.

Skilling hired some 250 bright young MBAs each year, all desperate to prove themselves so they, too, could hit the jackpot. Around Houston, a Porsche was seen as the Enron company car. "Skilling would say all that matters is money: You buy loyalty with money," says an ex-exec. Enron employees felt entitled to rich rewards. After all, Skilling and other top managers fostered the belief that they were the best and that they were on a mission to open markets across the globe in the face of entrenched, lumbering monopolies. Skilling "would trash other companies," recalls one banker. Indeed, he once compared Exxon Mobil Corp. to a floundering seven-mast clipper ship.

It's hard to remember that only a year ago, when he took the reins, Skilling was

widely hailed as a management genius and the toast of Wall Street. As he spread Enron's trading prowess into everything from metals to high-speed communications capacity, Skilling bragged that the stock—which hit a high of 90 in August, 2000—could easily hit 126. (In January, Enron was dropped from the New York Stock Exchange.) Many observers were inclined to give him the benefit of the doubt. After all, as a fast-rising McKinsey consultant, he had correctly predicted that then-regulated gas pipelines would face crushing liabilities from pricey contracts that required them to take gas at agreed-upon prices even if they no longer had customers willing to pay for it. And he saw early on how deregulation of gas and power markets would open vast new trading opportunities. In 1987, while still at McKinsey, he helped Lay create the first forward contracts for gas.

Skilling surprised his McKinsey col-

ENRON WATCH

leagues when he joined Enron full time in 1990. He quickly turned it into a laboratory for McKinsey's management ideas, adopting the concepts of such intellectual heavyweights as financial-markets expert Lowell Bryan and innovation guru Dick Foster. Over the years, as many as 20 McKinsey consultants worked for Enron, billing it in the tens of millions of dollars annually, says an ex-McKinsey consultant.

Skilling, whose father was a sales manager for a valve company, was used to success long before he joined Enron. An engineering student who went to Southern Methodist University in Dallas on a full scholarship, he fell in love with business classes, particularly the study of derivatives. After graduation, he landed a job in operations at First City National Bank in Houston and later moved into asset-liability management. One of his first projects was to come up with a computer model to catch check-kickers. The bank went under while Skilling was getting his Harvard MBA. In a comment that now seems ironic, he told *BusinessWeek* last year that he focused on risk controls at Enron because of what had happened at First City.

But if controls in Enron's trading units were not as strong as Skilling purported, some former and current employees say controls were in fact extremely weak in other parts of the company. Certainly, they say, he did little to control his closest confidantes. Many were executives who had helped him build Enron's wholesale-trading business and had risen with him through the ranks. "Once you gained Jeff's trust, the leash became really long," says a Houston headhunter.

One operation that ex-employees say was out of control was Enron Energy Services, the retail unit that managed the energy needs of such big companies as J.C. Penney Co. and Owens-Illinois Inc. According to former managers, Enron salespeople used wildly optimistic assumptions about the forward price of commodities and other factors to value their contracts. Huge profits were then booked upfront, though many of the contracts in fact produced losses in the early years. An Enron spokeswoman denies the allegation.

Yet Skilling himself seemed to see problems even as he was talking up the unit's success to analysts. Last spring, he led a reorganization of the operation, moving then-retail chief Lou L. Pai into a new venture-capital business. Pai was replaced by new managers from

ENRON'S EXODUS OF EXECUTIVES

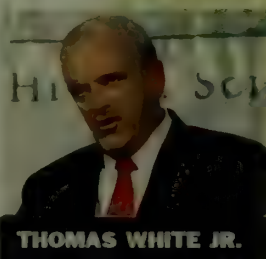
Jeff Skilling's resignation as Enron CEO last August stunned employees and investors. But several top execs had already abandoned ship:

KENNETH RICE	DEPARTED	LAST TITLE
	August, 2001	CEO, Enron Broadband Services

Helped create Enron's massive trading operation with Skilling. Took over the telecom unit, which is now suspected of accounting gimmickry.

LOU PAI	DEPARTED	LAST TITLE
	May, 2001	Chairman, Enron Accelerator

Spearheaded retail energy sales as head of Enron Energy Services. Left in February, 2001, to head a new investment arm. Left Enron three months later.



THOMAS WHITE JR.

THOMAS WHITE JR.	DEPARTED	LAST TITLE
	May, 2001	Vice-Chairman, Enron Energy Services

Served under Pai at EES, which critics now accuse of overvaluing its contracts. Left to become Secretary of the Army.

J. CLIFFORD BAXTER	DEPARTED	LAST TITLE
	May, 2001	Vice-Chairman, Enron

Once ran Enron's trading operation and later tried to sell its

troubled international assets. Had raised questions about Enron's investment partnerships. Baxter died on Jan. 25, an apparent suicide.

JOSEPH SUTTON	DEPARTED	LAST TITLE
	November, 2000	Vice-Chairman, Enron

Joined Enron in 1992 and took over its international operations. Critics say he overbid for an electric utility in Brazil in 1998.

REBECCA MARK-JUSBASCHÉ	DEPARTED	LAST TITLE
	August, 2000	Chairman and CEO, Azurix

Once headed Enron's international pipeline and power-plant operations. She then started Enron's troubled water-services company, Azurix.

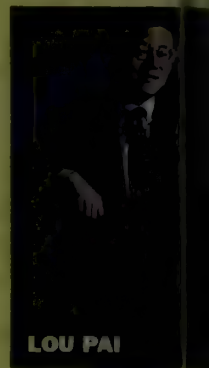
the trading operation who revamped the compensation system, cut costs, and pulled out of some markets. Pai's lawyer calls charges of accounting impropriety "nonsense" and insists it was Pai's own decision to leave.

Similar complaints about questionable accounting are echoed by an employee in the company's Risk Assessment & Control Division. Asset valuations done by the RAC unit were frequently increased by higher-level managers under the quarterly or twice-a-year review process, says the former employee. "We saw all these deals that had gone sour quickly and how we had booked a profit for them," the source says.

Did fears that such troubles would come to light cause Skilling to head for the door? Certainly, inside Enron, his departure was taken by some as a sign that deep problems were brew-

ing. Still, a former high school classmate recalls that Skilling seemed relaxed when he showed up with a date at the 30th reunion on Aug. 4. Skilling, whom the classmate remembers as "a kid who concentrated on the book work rather than the social aspects of going to high school," seemed less concerned about business problems than with his difficult divorce—he told former classmates that he had spent too little time with his family. "I think he said he was thinking about moving to the Bahamas or someplace like that," the classmate recalls. Whatever Skilling knew about Enron's woes, the scandal is sure to keep him from relaxing on the beach anytime soon.

By Wendy Zellner in Dallas, Christopher Palmeri in Houston, France in New York, Joseph W. in Chicago, and Dan Carney in Washington



LOU PAI



REBECCA MARK-JUSBASCHÉ

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ENERGY

ENRON: HOW GOOD AN ENERGY TRADER?

Without the accounting tricks, the company is not such a dynamo in its core business

Enron Corp. fooled a lot of people about its profitability for a long time. One way it did so was by appearing to do one thing very well: It dominated the trading of natural gas and electricity. It had the biggest market share in the booming business, and year after year posted higher earnings. Such success helped convince investors and analysts it could do equally well in trading other commodities, from pulp to airtime. And it gave Enron's black-box accounting the benefit of the doubt. Few quibbled with a company with such a genius for coining profits.

But exactly how good was Enron at trading energy? A new picture is emerging of the business that accounted for the bulk of Enron's \$100 billion in revenue in 2000. Yes, it was profitable. Potential buyers who examined Enron's books estimate its energy-trading unit earned about \$3 billion before taxes in the two years through last November. But Enron's profits were volatile—its traders took on more risk than the company has let on. And observers say the company smoothed out its profit stream by suppressing both the spikes and the dips in trading. The actions made Enron look better than it really was. "If they had played it straight, they still would have had decent results," says energy trader Art Gelber, head of Gelber & Associates in Houston. "But they would have lost their image of being so good that nothing could go wrong."

The growing evidence that even Enron's core business was not as stellar as believed has caused investors to lose confidence in the entire sector. Since Oct. 15, Mirant is off 63%, Dynegy is down 44%, Calpine is off 58%, and Williams is down 38%. Investors not only fear that some rivals may use accounting gimmickry similar to Enron, they're also concerned that increasing

competition will erode profit margins from trading.

Much of the worry stems from the fact that energy-trading earnings are based on so-called mark-to-market accounting. Energy traders must book all the projected profits from a supply contract in the quarter in which the deal is made, even if the contract spans many years. That means companies can inflate profits by using unrealistic price forecasts, as Enron has been accused of doing. If a company contracted to buy natural gas through 2010 for \$3 per thousand cubic feet, an energy trading desk could aggressively assume it would be able to supply gas in each year at a cost of just \$2, for a \$1 profit margin. Fearing such manipulations, investors are simply discounting the traders' prof-

GAMES ENRON TRADERS PLAYED

MISMARKING TO MARKET

Traders made unrealistic assumptions about future commodity prices so that their deals would look more profitable and their bonuses would be bigger.

CREATING SLUSH FUNDS

Many also stashed some money from profitable trades in "prudency" accounts, which they could draw on to cover bad trades. That made results look less volatile.

USING SWAPS

Through the use of complex financial instruments known as swaps, trading desks shifted profits from deals forward in time to smooth earnings.

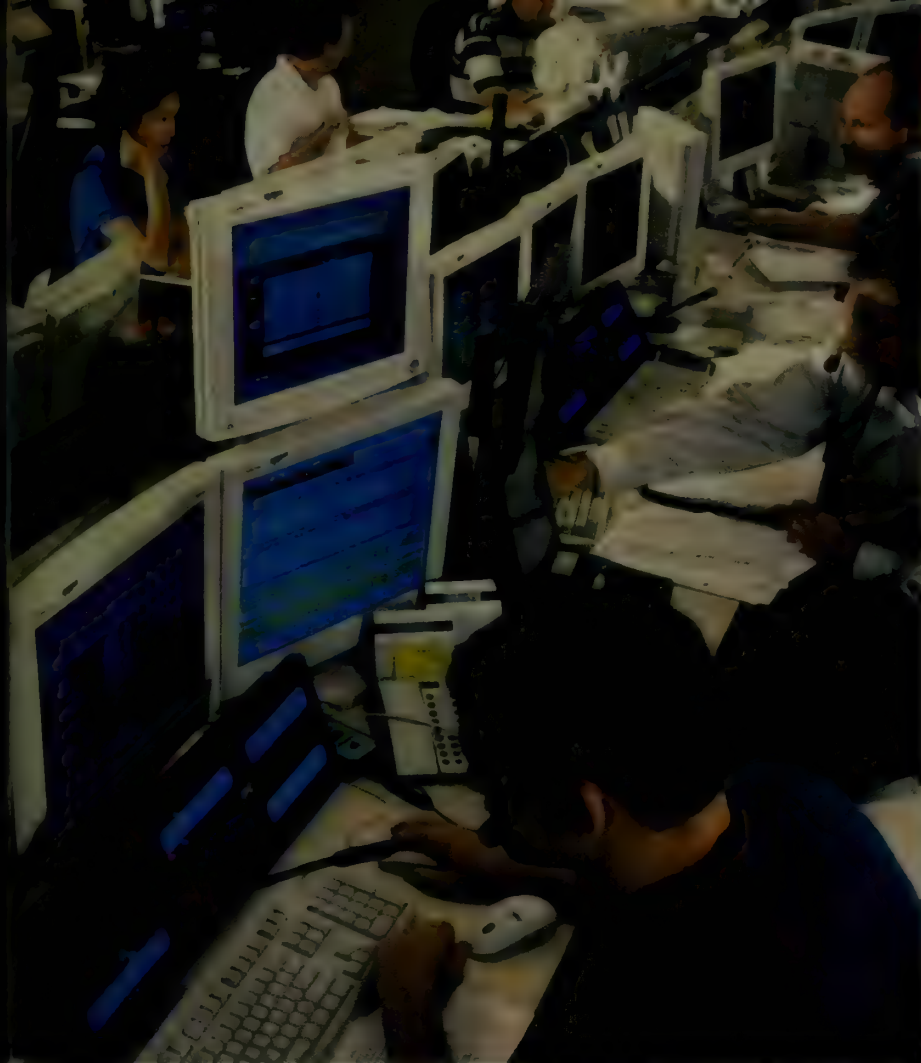
its from long-term contracts. "These stocks are being treated as if [the contracts] didn't exist," says John E. Olson, an analyst with Sanders Morris Harris Inc. in Houston.

Enron, which did not respond to questions about its trading and accounting practices, had ample opportunity to abuse mark-to-market accounting. For one, it specialized in exotic contracts that entailed delivering energy over long periods of time. Enron had some contracts going as far out as 24 years—some signed by its small, unprofitable retail business known as Enron Energy Services. The valuations it used to book profits on such contracts are now widely believed to have been

significantly inflated. "That's valuable by rumor. There's no way for those results to be taken seriously," says F. F. McCullough, a power-industry consultant in Portland, Ore.

Still, about three-quarters of Enron's trading volume involved relatively short-term contracts for gas and electricity where futures prices are well-established. For those short-term deals, seasonal forecasts are much harder to fudge and more easily spotted. Enron's risk managers, responsible for determining the actual profitability of deals, had more control in the energy business than elsewhere in the company. Overall, mark-to-market accounting was less prevalent in energy trading





ON THE FLOOR

Investors now give energy companies little or no credit for long-term deals

The revelations of the accounting gimmickry have left former rivals in the trading business with a big problem: the need to distance themselves from Enron's practices to

regain investors' confidence. "Enron wasn't disclosing, and yet it was trading at high multiples. So in a way [the market was] incentivizing companies for not providing information," says Jeffrey A. Dietert, a stock analyst at Simmons & Co. International.

Now, companies are disclosing financial information in numbing detail. Duke Energy emphasizes that only a fifth of its energy business is valued on a mark-to-market basis—and of that, over half is for contracts lasting two years or less. Others are also pushing hard to convince investors there is real money to be made in energy trading. "The competitive wholesale markets have proven they are robust, viable—and they will continue," says S. Marce Fuller, CEO of Mirant Corp. Enron's fall actually gave a boost to rivals by freeing up customers and slightly widening the profit margins on trades.

Still, profits aren't what they once were. Increased competition has cut gross margins from about 5% five years ago to about 1% or 2% now, according to one industry analyst. "My suspicion is the margins may be pretty flat for a long time," predicts analyst Dietert.

The toughest task ahead may be faced by Enron's former energy-trading operation, which is about to be taken over by the Swiss-owned investment bank UBS

Warburg. Assuming federal antitrust authorities give the nod to the deal, UBS Warburg plans to rebuild the unit slowly and operate it with tighter controls. "Entering into energy trading does not mean extending our appetite for risk," says UBS President Peter A. Wuffli in Zurich. Such conservatism, of course, might drive away Houston-based traders who earned as much as \$1 million a year in Enron's freewheeling culture. But the new operators make no apologies. "We are risk-management junkies," says John Costas, CEO of UBS Warburg. After the biggest bankruptcy ever, everyone in the business is singing that tune.

By Peter Coy in New York and Stephanie Anderson Forest in Dallas, with Dean Foust in Atlanta and Emily Thornton in New York

in other sectors, such as Enron Energy Services, people familiar with company say.

The more common game in Enron's trading business was to smooth earnings rather than inflate them. While it may seem like a comparatively minor infraction, it had huge consequences. It gave the appearance that Enron's earnings stream was highly reliable, which helped to pump up the stock price. Efforts to justify that valuation of the company as a whole into increasingly desperate efforts to achieve growth and hide losses.

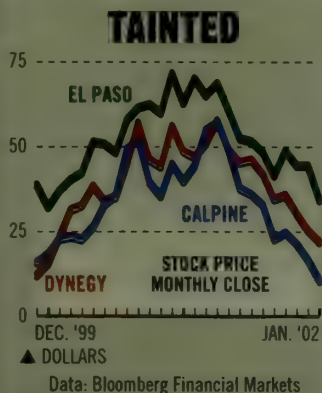
Frank Partnoy, a University of San Diego law professor who is writing a book on Enron, testified before the Senate Committee on Governmental

Affairs on Jan. 24. According to his reports from several insiders, Enron created a slush fund known as a "prudence" account. Partnoy says they used the account to even out the reported profitability of trades, putting money in the prudence account when trades were not optionally profitable and withdrawing mon-

ey to dampen the losses from bad trades. Randall Dodd, director of the Washington-based Derivatives Study Center, says Enron also smoothed income using swap deals. In such cases, a stream of payments could be shifted either forward or backward in time, depending on when the company or the traders themselves wanted to recognize income.

Enron's trading business had another undisclosed problem. It took on far more risk than it had let on to achieve the profits it made. Its reported value at risk from trading averaged \$66 million a day in 2000. That means the company calculated there was a 5% chance of losing or making at least that much on any given day. The number had tripled from 1999 as trading volume and risk-taking grew, and insiders say it stayed at the higher level in 2001. And even that may understate the risk. Partnoy says people told him Enron deliberately reduced its trading portfolio's riskiness on the day each month when the value at risk was measured.

ENRON WATCH



A VIEWER'S GUIDE TO THE ENRON HEARINGS

The ones to watch for revelations, entertainment, or just some quality shut-eye

Save some of Sunday's Super Bowl pizza because on Feb. 4, Washington will begin its own weeklong spectacle: a slam-bang scandal replete with shredded documents, whistle-blowers, tearful retirees, fleeced investors, sham offshore subsidiaries, huge campaign contributions, White House stonewalling, a scapegoat, a suicide, and a millionaire exec with a wife crying poverty.

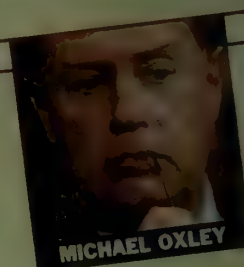
So far, a dozen Capitol Hill committees are scrambling to snag witnesses, obtain documents, and reserve hearing rooms. With so many committees vying for eyeballs, there's bound to be exciting testimony, shocking revelations, and a rising star politician. Here comes the Enron Bowl:

By Paul Magnusson, with Mike McNamee, Lorraine Woellert, and Laura Cohn, in Washington

POTENTIAL SLEEPER ★★★★★



REPRESENTATIVE MICHAEL G. OXLEY (R-Ohio), chairman of the House Financial Services Committee, will attempt on Feb. 4 and 5 to cast ex-CEO Kenneth L. Lay in the role of Dr. Frankenstein and portray Andersen CEO Joseph Berardino as Igor. Also on the grill is SEC Chairman Harvey L. Pitt for his inaction on accounting shenanigans. Oxley wants to paint this as a corporate, not political, scandal and to help distance President Bush from first pal "Kenny Boy."



MICHAEL OXLEY

TOUGHEST HEARING ★★★★★



SENATOR CARL LEVIN (D-Mich.) chairs the permanent subcommittee on investigations of the Governmental Affairs Committee, historically a vigorous panel that's armed with subpoena power. A rump, plodding, liberal reformer, Levin may provide the hottest seat for corporate miscreants once he gets rolling. Levin wants new regs on industry—lots of 'em. He also wants to send the message that the GOP's hands-off approach to business doesn't work.



CARL LEVIN

BEST DRAMA ★★★★★



THE PRIZE IS LIKELY TO GO TO THE CAGEY CAJUN, House Energy & Commerce Committee Chairman Billy Tauzin (R-La.). Tauzin released the letter from whistle-blower Sherron S. Watkins warning that Enron was about to "implode" in an accounting scandal. He is sitting on 80 boxes of hot docs, certain to yield more outrages. On Feb. 5, he'll have Enron Director William C. Powers Jr. in the dunking chair. Tauzin aims to be the lead story on the evening news.



BILLY TAUZIN

BEST COMIC RELIEF ★★★



POPULIST ERNEST "FRITZ" HOLLINGS (D-S.C.) chairs the Senate Commerce Committee and is widely known for his Southern wit: He once quipped that if President Clinton's popularity recovered from the Lewinsky scandal, "He can start dating again." Fritz plans to flay Lay early on Feb. 4. There will be laughs for sure. Hollings could get stricter regs on 401(k) pensions and accounting firms.



ERNEST HOLLINGS

BIGGEST YAWN ★★



CAUTIOUS JOSEPH I. LIEBERMAN (D-Conn.), chairman of the full Senate Governmental Affairs Committee, wants to look substantive and bipartisan, since that's the best persona for his 2004 Presidential ambitions. His committee's ranking Republican, Fred Thompson (Tenn.), will go with gravity, too. Still, Lieberman risks viewer fatigue if early shows have all the good stuff. Staffers, apparently from the Planet Tedium, insist they'll be looking at the big picture.



JOE LIEBERMAN

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In Business This Week

EDITED BY MONICA ROMAN

RESULTS XEROX HOPES TO DUPLICATE

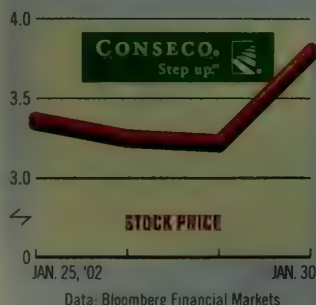
AT LAST, SOME GOOD NEWS from Xerox: On Jan. 28, the company announced that it posted an operating profit in its 2001 fourth quarter, excluding restructuring charges and not counting the impact of unhedged currency. CEO Anne Mulcahy hailed the results as "an important milestone in Xerox' turnaround." Investors agreed, driving the stock up 14%, to \$11.24 a share, that day.

Still, plenty of issues remain for the copier maker, including a Securities & Exchange Commission probe into its lease accounting, the continuing search for a new chief financial officer, and so far unresolved negotiations with bankers regarding a \$7 billion revolving credit line that expires in October. Also, sales were down 13% in the quarter, and even though the company is predicting profitability for the coming year,

CLOSING BELL

BIG PREMIUM

Shares of Consecro rose 18%, to \$3.81, on Jan. 30 after the Carmel (Ind.) insurance and loan company said it would raise as much as \$800 million in cash by repurchasing bonds, selling some assets, and expanding a credit line. The cash will be used to pay down debt and offset any earnings shortfall.



next quarter will probably bring fresh losses.

MAKING HEADWAY AT GATEWAY

THE PC PRICE WAR IS BACK on. Gateway slashed its prices for desktop and notebook computers on Jan. 28, undercutting market leader Dell Computer by as much as 20%. Higher prices had helped Gateway turn in a \$5.1 million profit in the fourth quarter, but the Poway (Calif.) PC maker now says it needs to rebuild its market share, which fell to 6.3% in December from 7.8% in September, according to IDC. Gateway will take pretax losses for the coming few quarters, cut 2,250 jobs, and close 19 of its 296 Country Stores. Not to be outdone, market-leader Dell lopped as much as \$200 off the price of some PCs, and is doubling the size of hard drives for free.

NO FUN AND GAMES AT TOY 'R' US

THESE ARE SERIOUS TIMES IN toyland. Despite a surprisingly strong Christmas season, when Toys 'R' Us stores bucked a bad economy to sell 5% more Monopoly games, Lego blocks, and Barbie dolls than the year before, CEO John Eyler is making big cuts. On Jan. 28, he said he would close 27 toy stores and 37 Kids 'R' Us stores, eliminate 1,900 jobs, and take a restructuring charge of \$213 million. Eyler estimates that the cuts will add \$25 million to pretax earnings in 2002 and contribute \$45 million a year starting in 2003. Since Eyler took over the company two years ago, he has remodeled 433 toy stores, worked to improve customer service, and stacked the shelves with exclusive toys in a bid to beat discount-store competition.

HEADLINER: LOUIS CAMILLERI

MORE THAN JUST A NUMBERS GUY

BREAK OUT THE SMOKES and cheese. Philip Morris on Jan. 30 named its chief financial officer, Louis Camilleri, to be its new president and CEO. Camilleri, 47, will take over the job from Geoffrey Bible—who stays on as chairman—on Apr. 25. Camilleri cast his appointment as the continuation of a great regime, calling Bible a "veritable institution" while pledging to build on his "enormous legacy and outstanding track record."

Still, analysts welcomed Camilleri's promotion, noting that he is more than just a numbers guy.



Among other things, Camilleri expanded the company's tobacco business in Central and Eastern Europe, headed up corporate planning, and even acted as CEO of Kraft Foods' international operations. Camilleri is expected to be sav-

about unlocking shareholder value, from stock buybacks to a possible tracking stock for tobacco. "This hasn't been the most sophisticated company in terms of financial engineering," says Campagnino, an analyst with Prudential Securities. "He could change that."

Diane Br

DILLER'S DOOZY OF A QUARTER

BARRY DILLER'S BET ON interactive commerce seems to be paying off. Growth in online travel and Internet dating helped boost fourth-quarter revenues at his USA Networks by 33%, beating Wall Street estimates. The protracted ad slump took its toll on USA's cable channels, including its flagship USA Network, which Diller recently agreed to sell to Vivendi Universal. That deal could close within weeks, said Diller. Rid of its entertainment holdings, the company raised its 2002 estimates.

THE YAWN THAT GREETED MERCK

MERCK THOUGHT IT HAD found the right remedy for its ailing stock price. On Jan. 29, the drugmaker announced it

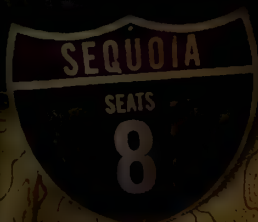
would spin off Merck-Mitsubishi's pharmacy-benefit-management company, in the hope that the stock market would reward it for focusing on drug business. But Wall Street yawned, sending Merck's stock up less than 1%, to \$57.10. The reason? The spin-off does little to offset pressure from patent expirations and a weak new-drug pipeline. "This deal does not change the underlying value in their drug business," says John Borzilleri, portfolio manager at State Street Research & Management.

ET CETERA...

- Crossmann Communities will be acquired by B&B Homes for \$603 million.
- Mirant may sell all or part of its European marketing risk-management operations.
- ABB doubled the amount set aside to cover potential asbestos liability, to \$940 million.



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Microsoft

EDITED BY RICHARD S. DUNHAM

GLOBAL CROSSING TOSSED MORE CASH AROUND TOWN THAN ENRON

Enron has become Exhibit A for campaign-finance reform, Global Crossing's adventures in Washington make for even more audacious—and cautionary—tale of influencing. While Enron spent years cultivating lawmakers party chieftains, the telecom upstart shot to the top of political donors almost overnight. Global Crossing, filed for bankruptcy on Jan. 28, became a lobbying powerhouse just as fast, as it sought help from lawmakers regulators to expand its international cable network.

Global Crossing, founded in 1997 by Gary Winnick, a former junk-bond salesman and associate of Michael Milken, contributed \$2.9 million to candidates and political parties during 2000 election, up from just \$34,000 in 1998, according to the nonpartisan Center for Responsive Politics (CRP). That made Global Crossing-based in Beverly Hills and Bermuda, the highest donor among communications companies—ahead of WorldCom and BellSouth. It even topped Enron's \$2.4 million in such donations for 2000. "They came out of nowhere and doped the town with money," says Larry Hanson, executive director of CRP.

The then-high-flying telecom was an even bigger giver: Of its total \$3.6 million in contributions since 1998, Republicans pocketed 47%. Top recipients in Congress were key figures in telecom regulation. Senator John McCain (R-Ariz.) got \$31,000, and Representative Edward J. Markey (D-Mass.), \$12,500. In 1999, on behalf of Global Crossing, McCain asked the Federal Communications Commission to encourage the development of undersea telecom cables.

At the high point of Global Crossing's nonideological courtship in the summer of 2000. The company dished out \$250,000 to the party's convention, hosted lavish parties for pols such as Majority Leader Tom Daschle (D-S.D.), and provided

all of the Web hosting and connections for the GOP's confab.

Winnick collected powerful friends the way some moguls collect art. The company's onetime president, Leo Hindery Jr., is a top Democratic fund-raiser. Its vice-chairman, Lodwick Cook, a former ARCO exec, is a prominent GOP giver and friend of ex-President George Bush. In 1998, Bush père made a speech in Tokyo on behalf of Global Crossing and pocketed shares of stock in lieu of \$80,000 for his fee. His holdings were worth millions a year later, when he filed papers to sell some shares.



BINGAMAN: \$2.5 mil worth?

In 1999, Global Crossing was planning to lay a transpacific fiber-optic cable and faced competition from a powerful consortium of companies, including AT&T and WorldCom. Winnick hired Anne Bingaman, former Justice Dept. antitrust chief from 1993-96, and Greg Simon, a former domestic policy adviser to Vice-President Al Gore, to lobby the Federal Communications Commission. Global Crossing paid Bingaman, now chairman of Valor Communications in Irving, Tex., an unprecedented \$2.5 million for six months' work. The company failed to block the rival group from getting a license but did force it to modify its proposal in ways so it couldn't dominate the market.

Global Crossing wasn't the only brash New Economy company to cut a swath in Washington. But it raised eyebrows because its largesse was so out of proportion to its needs—mostly routine regulatory approvals rather than high-profile legislation. "With Enron, you can list lots of examples of doors that were opened to them," says CRP analyst Holly Bailey. "With Global Crossing, it's hard to fill a page." For Winnick, who was in a hurry to build a global telecom system, the price may have been right. He's now learning, though, as Enron has, that paying the pols won't keep the debt collectors away.

By Amy Borrus

CAPITAL WRAPUP

TOP CHASING CHENEY

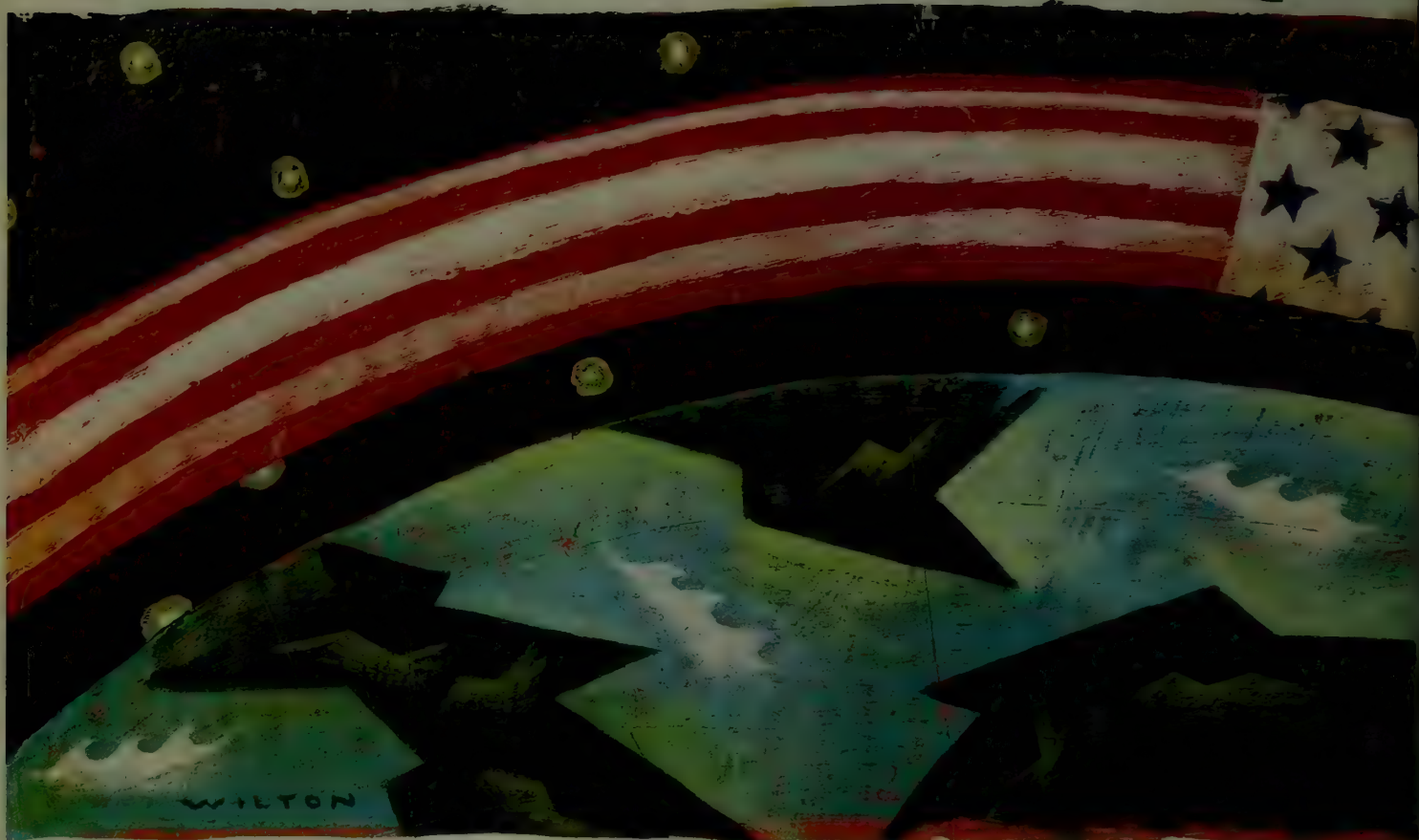
At least one member of the green-shade set is taking his job seriously. Hours after the State of the Union address, U.S. Comptroller General David M. Walker, the feds' top auditor, said he would sue the White House to gain details on Dick Cheney's meetings with energy interests last year. Walker, as head of Congress' investigative General Accounting Office, wants to see what they discussed while Cheney was crafting energy policy.

Enron and Cheney aren't Walker's only targets. On Jan. 25, Walker, a former partner at Arthur Andersen, moved to force accounting firms to apply a higher standard to their government audits than to their private ones. Walker hopes his new rules will help the push for stiffer overall standards. He has invited execs from the Big Five, FASB, the Conference Board, and others to a Feb. 25 closed-door meeting at which he hopes to persuade them to tighten their self-regulation, too. A summary of that meeting will be made public, Walker assures *BusinessWeek*.

What is Walker getting for his efforts? Serious heat from Republicans, who are steamed that Walker would butt heads with the White House just a day after Bush's Big Speech. Others question his stance on accounting regs, given his former role at Andersen. "We need a GAO to investigate the GAO," says one GOP aide. But Walker might be the only person in Washington diving into the Enron scandal without risk. An independent, Bill Clinton appointed him to a 15-year term in 1998. The only way to get rid of him is impeachment.

By Lorraine Woellert

5 CRITICAL QUESTIONS



1 WHAT KIND OF SUPERPOWER?

Now America is out to contain terrorism by stabilizing weak states that seek its help

The major bombing raids are over. The Taliban is vanquished. The remaining al Qaeda terrorists in Afghanistan are on the run. The surprise of the decisive U.S. victory is wearing off as a new local government hunkers down to rebuild the country. But the significance of America's show of power is still being pondered and debated around the world.

Where does the U.S. go from here?

That's the question asked everywhere these days, from the corridors of power in Beijing to the White House situation room. The Administration may soon have an answer. Even though President George W. Bush in recent weeks has turned his attention to domestic issues such as the economy and the failure of America's seventh-largest corporation, Enron Corp., he and his foreign policy team are drawing up and refining blue-

prints not only for the anti-terror war but also for a new American foreign policy.

U.S. troops are moving in as aid to governments fighting terrorists in the Philippines and Somalia. Other targeted military operations are possible, but what's more important—even radical to this President—is the Administration's sweeping new foreign policy agenda, still a work in progress and has not been officially unveiled. It builds on what is coming known as "the Bush doctrine," the notion that states must take responsibility for what goes on inside their borders. Essentially, Bush has decided he wants to use America's status as the sole superpower not only to fight terrorists and countries that willingly harbor them, but also to help weak and unstable states that might naturally attract terrorists. Bush's National Security Advisor, Condoleezza Rice, explained what he called phase two of the Bush doctrine in a recent interview: "For the

TIONS

September 11 shattered the old certainties. What will arise in their place?



foreign policy may question the new policy. The faction of the Republican Party Bush represents "does not buy into liberal internationalism," notes Charles A. Kupchan, director of Europe Studies at the Council on Foreign Relations. Still, most Republicans in Congress are expected to line up behind their President in wartime.

One reason skeptics may go along is that the Bush team promises a flexible approach—just as it has with the military campaign, which has relied on proxy forces. In some cases, U.S. soldiers, technical specialists, or diplomats will directly intervene in a weak nation that requests

specialists are piecing together a program to boost health care and help refugees. The Administration is recruiting the backing of South Africa and other neighbors to help enforce the peace. And the cost for the U.S. is a relatively modest \$200 million a year, for humanitarian relief and financial backing for African and U.N. peacekeepers.

Even as the Bush team attempts these diplomatic experiments, however, it will still prove hard for them to abandon their original vision. The Administration began its term with a focus on a few key countries and regions: China, Russia, India, Japan, and Europe.

NEW VISION

America's involvement may range from helping nations improve border controls to building infrastructure

And it adopted a unilateral, Lone Ranger style, pushing for missile defense despite criticism around the world. That approach seemed to change after September 11 as the U.S. assembled a broad-based international coalition to combat terrorism. But critics suspect the Administration may revert to its unilateral instincts if the terrorist threat eases. And that could make it harder to capitalize on the success in Afghanistan. "How do you stay a world leader if you take the interest of others into account only when you believe they coincide with yours?" asks Dimitri K. Simes, president of the Washington-based Nixon Center. The world is waiting to see how George Bush & Co. will handle this question.

By Stan Crock in Washington, with bureau reports

BusinessWeek online

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es that want to take responsibility, to act responsibly, we're going to be able to help," she says.

How? The Administration envisions helping governments in improving their border controls, intelligence capabilities, ability to track terrorists' finances. U.S. may support infrastructure projects, such as the building of new communications networks, or back institutional reforms, such as the overhaul of judicial systems. The idea, says Rice, is to strengthen states against lawlessness and corruption—"the very things that keep investment and economic development from taking place." The Administration has "had multiple discussions and requests from states around the world," she adds.

sounds a lot like nation-building—the very concept Bush decried during his election campaign. That's why some Democrats wonder if he's serious. Conservatives who favor a more isolationist for-

help. In others, neighbors can step in. Washington also aims to rely heavily on the World Bank, the U.N., and other international organizations. "The U.S. can't do it alone," says Rice. That in itself is a shift from the Administration's own skeptical attitude toward multilateral agencies before September 11. It's unclear, however, how effective the new policy will be. The Administration isn't planning to put much money into advancing this phase of the Bush doctrine. This year's \$9.6 billion foreign aid budget is expected to rise only marginally in fiscal 2003.

Already, though, the Bush team is trying out its approach in a few feeble states. One is the Democratic Republic of Congo, where war has raged since the mid-1990s. Officials fear that it could become a haven for terrorists. Bush emissaries are pushing to get Rwanda, Uganda, Angola, and Zimbabwe to comply with a 1999 agreement to remove their armies from the Congo. Other aid

2 WHAT'S NEXT FOR THE GLOBAL ECONOMY?

A mild U.S. recovery will be a bright spot in a world fraught with risk

The 16-hour waits for trucks are gone at the busy Ambassador Bridge linking Detroit to Windsor, evidence that the \$1.2 billion-a-day trade between the U.S. and Canada is back to normal. Outside Paris, tourists again are flocking to the Euro Disney theme park, and a second phase of the park is on schedule to open in March. And near Lower Manhattan's Ground Zero, the Ritz-Carlton chain has just opened a new luxury hotel.

As the global economy enters 2002, the good news is that the worst fears about the impact on business from September 11 have not materialized. Most signs point to a U.S. recovery by spring, buoying hopes from Mexico to Germany. In South Korea and Taiwan, electronics exporters report orders already are picking up.

But how strong a recovery? And how broadly will it be felt around the world? The outlook remains hazy. "Japan continues to spiral down, Argentina's a mess, Europe is slow. There aren't many bright spots out there," says Maurice Greenberg, CEO of insurance giant American International Group.

These are only the immediate worries.

Try looking further out, and you encounter a great irony. In terms of global security, the U.S.-led war on terrorism has provided world leaders with a strong sense of common mission. But such clarity no longer exists on the future shape of the global economy. A decade ago, the march toward open markets for goods and capital consumed U.S. foreign policy. Now, in place of certainty are only questions: Can a new consensus be built for freer trade amid a growing disillusionment with the fruits of globalization? Will much of Southeast Asia, Latin America, and Africa be left behind? Can borders be secured from future terrorist attack without jeopardizing the openness vital for just-in-time commerce? "There is a feeling of fragility now in the world," says Accenture International Vice-Chairman Vernon Ellis. "A lot of issues have to be managed very carefully."

How such challenges are handled determine whether or not 2002 may return to sustained global prosperity. World Bank projects global growth in 2002 of just 1.6%—a shade better last year and far below 2000's 4% Factor in population growth, and there's no rise in global per capita income. International Monetary Fund projects world trade—a global growth engine of the 1990s—will expand by just 1% in 2002. That's little better than 2001, the year for trade in a decade. And if U.S. recovery sputters, warns Morgan Stanley Dean Witter & Co. global strategist Stephen R. Roach, "the world will be a tough place." He figures the U.S. accounted for 40% of global growth in 1996. "The world economy has become overdependent on the U.S.," Roach says.

Here's a look at 2002's top challenges.

Commercial Security: Beefed-up security and better ship documentation quickly cleared up snags at the U.S. border crossing. But the larger remains: "How the U.S. defense 4,000-mile border not damage its economy?" asks F. Smith, customs administration director for General Motors Corp. Technology

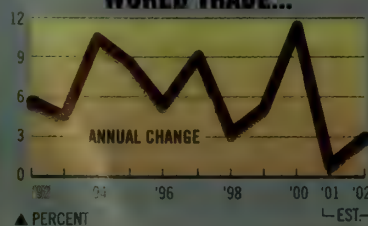


ANOTHER DREARY YEAR FOR THE GLOBAL ECONOMY

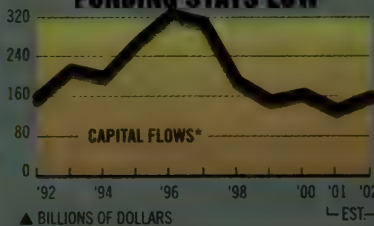
GROWTH WILL STAY SLUGGISH...



...AND SO WILL WORLD TRADE...



...WHILE EMERGING MARKET FUNDING STAYS LOW



*INCLUDES DIRECT INVESTMENT, FOREIGN AID, LOANS, EQUITY INTO DEVELOPING NATIONS

the key. The U.S. and Canada are opening systems to monitor goods, and drivers electronically before arrive at borders, cutting the need physical checks. "We want a smart one that is seamless as well as e," says Canadian International Minister Pierre S. Pettigrew. That depends on whether Congress will the billions needed to bring U.S. customs into the 21st century.

Japan's Crisis: The \$1 trillion question is whether Tokyo's financial system will really blow up this year. But assume Japan Inc. muddles through again. There's still little stopping the yen's slide, down one-third in two years to around 134 to the U.S. dollar. If it falls below 140, South Korea, Taiwan, and export-led neighbors may devalue. Should Beijing follow suit, "that will create enormous storms in Asia," frets Chang Il Hyung, senior vice-president at Korea's Samsung Electronics.

The Developing World: A U.S. recovery would Mexico, which shed 380,000 work-at year due to the slowdown, and Asian exporters. But for most otheloping nations, 2002 looks like er year of stagnation. Though on emerging-market debt have ed from the stratosphere after Arna's default, new credit remains e. "Bankers now know the IMF solve all problems," says Joseph ez, credit risk director for KPMG ulting Inc.

there's a positive outcome of Sep-er 11, it's the higher sense of ur- in the West about the severe ty of terrorist hotbeds like yistan and Pakistan. "Globalization owing the free movement of peoney, and information," says Mark ch Brown, boss of the United Na- Development Programme. "But's a concomitant risk if you let half e globe be unduly poor and under-eged." Hundreds of corporations support campaigns to fight tropical e and promote literacy. The U.N., l Bank, IMF, and World Trade Or-ation are hammering out a common to help the 1 billion people living on day or less. But the Bush Adminis-on already has signalled it won't en- one key goal: a \$50 billion annual in foreign aid by rich countries.

Trade: China's WTO entry and the agreement to start new global e talks were big victories. But

what these talks will achieve is unclear. President Bush has promised to protect U.S. farm, textile, and steel interests. Europe aims to keep lavish agriculture subsidies. And poor nations are more united in pushing their own agendas. Says Indian Commerce Minister Murasoli Maran: "From now on, developing countries will think hard before signing any multilateral treaty." As a result, there are new calls in Asia for a regional trade bloc. And in Latin America, support for the Free Trade Area of the Americas champi-

oned by Bush is fading fast. "Entire regions are moving in different directions," warns George Friedman, chairman of Dallas-based risk consultancy Stratfor Inc. "That can cause huge frictions between countries."

That's one possibility, but it's not inevitable. To build a healthy global economy will require management, diplomacy, resources, and optimism—a feeling in short supply in the world these days.

By Pete Engardio in New York, with bureau reports

3 WHAT IS MOSCOW'S NEW ROLE?

The former superpower finds itself a junior partner to the U.S.

Take this. Now take that. Over the past six weeks, the Bush Administration has made Russia feel the back of its hand. First, Washington told Moscow of its plans to withdraw unilaterally from the Soviet-era Anti-Ballistic Missile Treaty. Then the White House scolded the Kremlin for using excessive force in Chechnya and for seeking to stifle freedom of the press. Finally, the Administration said that rather than destroy nuclear weapons, as sought by Moscow as part of a proposed new arms-reduction pact, the U.S. might simply put warheads in long-term storage.

How has Moscow responded? With barely a peep. The invitation is still on for George W. Bush to visit Moscow at midyear to sign, the Kremlin ardently hopes, that new weapons-cut agreement. Thus does Russian President Vladimir V. Putin seem determined to preserve at almost all costs his bid for a close strategic partnership with the U.S. While it would be political suicide for him to say so openly, Putin appears to be tacitly accepting a post-September 11 arrangement in which a humbled Moscow plays a subservient role in a global order dominated by the U.S.

The Bush Administration is calculating that Putin's Russia has no better choice than to accept this decidedly junior partnership. That's a cold-eyed view and probably right. Even as the lesser partner, Russia stands to gain from U.S. efforts to speed its entry into the World Trade Organization, possibly as early as 2003, and to acquire a weightier consultative role in NATO, if not actual membership anytime soon. Meanwhile, U.S. troops stationed in Central Asia are protecting Russia from Islamic militants—an enemy Russia's tattered military lacks the resources to combat on its own.

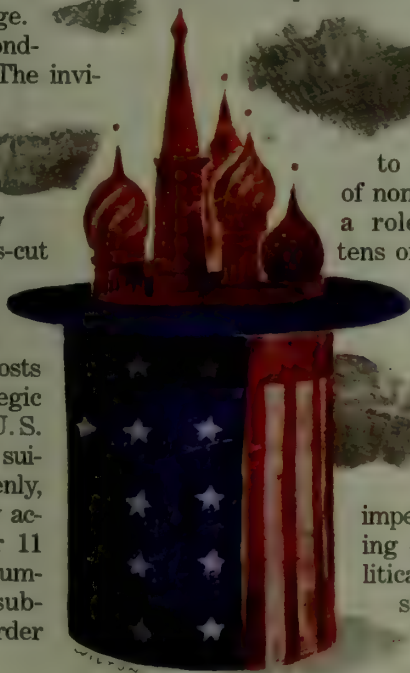
No other world power with whom Russia could possibly link up as a long-term strategic alternative to the U.S. could offer such a range of benefits. And

despite the abrupt behavior of the White House, the

U.S. isn't asking for all that much in return:

It wants Russia to be a secure supplier of non-OPEC oil to the West, a role that earns Russia tens of billions of dollars annually, and to share intelligence on Islamic militant groups that threaten the U.S., Western Europe, and Russia alike.

The end of the imperial dream is not proving easy for Moscow's political and military elite to swallow. A decade after the collapse of the Soviet Union, many



of yesterday's cold warriors are still in denial: In an unusual public criticism of Putin, more than 20 retired generals recently signed a letter protesting his declared plan to shut down Soviet-era bases in Cuba and Vietnam. While duly noted, the protest is unlikely to have any impact.

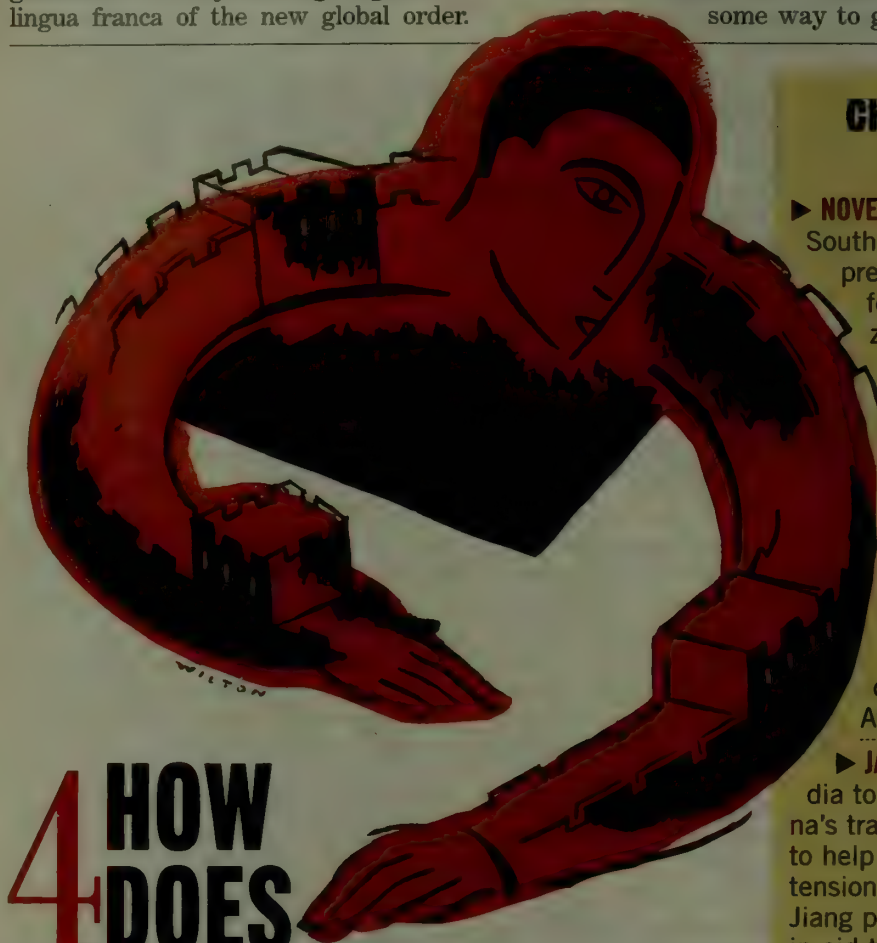
Yet ordinary Russians, weary of grand causes, appear to be following their President's lead. In Russian schools, a new generation is busily learning English, the lingua franca of the new global order.

And nostalgia for Russia's lost superpower status seems to be diminishing.

It's possible that cocky Bush Administration hardliners will overplay their hand. The big test may prove to be Saddam Hussein's Iraq, a likely eventual target of Washington hawks. Russian oil outfits have important interests in Iraq, and Putin has said many times that he's against a major military strike. If the U.S. decides to launch one without finding some way to get Rus-

sia onboard, then Putin may have no choice but to retreat from close relations with the U.S. But even on this point, it may be possible to reduce Putin's position if Bush offers guarantees. Russian oil companies will get a slice of the business in a post-Saddam Iraqi regime, says Moscow defense analyst Andrei A. Piontkovsky. For Putin's Russia is content to suffer the lectures of its senior partner.

*By Paul S. ...
in ...*



4 HOW DOES CHINA PLAY ITS HAND?

Beijing is trying, subtly, to stem the tide of U.S. political influence

Imagine China's chagrin. Just months ago, it was one of the few nations willing to tangle with Uncle Sam. Remember Beijing's huffing over U.S. military help to Taiwan? Or how it went ballistic over the spy plane incident and took its sweet time giving America its plane back—in pieces? All

along, China was strengthening military ties with Burma, cozying up to longtime rival Vietnam, forging ties with Russia and the Central Asian "Stans."

Then came September 11. Now, thanks to its swift dispatch of the Taliban, the U.S. walks taller than ever. In fact, its military has set up shop in China's backyard. "Before the terrorist attacks, China frequently criticized hegemonic tendencies," says Zhu Feng, director of the International Security Program at Beijing University's School of International Studies. "Now the world is becoming more hegemonic." If China's leaders feared containment before, they probably feel surrounded now.

So Beijing has launched a charm offensive. Jiang & Co. are working hard to

CHINA'S CHARM OFFENSIVE

► **NOVEMBER** In a trip to Southeast Asia, Chinese premier Zhu Rongji calls for an Asian free-trade zone—a bid to counter Japanese influence.

► **DECEMBER** Chinese President Jiang Zemin visits Burma to strengthen close military ties. That same month, Pakistan President General Pervez Musharraf visits Beijing twice to discuss the Afghanistan war.

► **JANUARY** Zhu visits India to build ties with China's traditional opponent and to help defuse India-Pakistan tensions. The same month, Jiang pledges \$150 million in aid to Afghanistan, during the visit to Beijing of interim Afghan leader Hamid Karzai.

Data: BusinessWeek

portray China as a constructive, nonthreatening new power. Says Kenneth D. Thompson, former Assistant Secretary of Defense in the Clinton Administration: "China has been trying to create an important role for itself. One of Beijing's goals: to undo U.S. influence but become a fait accompli."

Consider Zhu's five-day trip to India. Chinese premier visit in more than a decade. Ostensibly to forge closer ties, it also sought to mend Washington's friendship with Delhi. China also wants to profit from India's weakness. In a November trip to Southeast Asia, Zhu called for an Asian free-trade zone. With luck, Southeast Asia will look to China as the new center of economic gravity. China also wants to show a benevolent

by arbitrating regional disputes and contributing money and equipment to keeping operations, as it has already done in Cambodia, East Timor, and Bosnia.

Still, many Asian nations would like to see the U.S. Navy to Chinese gunboats trolling shipping lanes. And both Taiwan and the U.S. have expressed interest in U.S. plans for regional missile defense. These nations know that China, while playing nice, can play mean later. "China is a big power, and it will project like [one]," says an Asian diplomat in Beijing. "We all have to live with it. Of course. But it won't always be nice."

*By Dexter Roberts in Beijing
Brian Bremner in Tokyo*



WHAT KIND OF DECISIONS ARE REQUIRED IN TODAY'S BUSINESS CLIMATE? SMART ONES.

ing at a smart business
ion can happen anywhere.
he process first requires
mation; information that
s to be gathered from multi-
sources, then analyzed and
ed before it can be used to
advantage.

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create and distribute actionable
information? And, two; also
meet the demands to reduce
costs and increase productivity?

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5 WILL THE ARAB WORLD EVER CHANGE?

Don't count on it. Mideast leaders are likely to dig in their heels

For the U.S. and its allies in the fight against terrorism, few goals could be more important than making sure the Middle East is firmly on the way to stability—and away from extremism. After all, it was militants from the Middle East who executed the September 11 attacks on the U.S.

But don't count on it happening soon. For starters, the highly conservative governments in the Arab world look more likely to dig in than to change. On top of that, the Bush Administration has failed to come up with a coherent policy for the region. Washington's laissez-faire stance to Palestinian-Israeli fighting is turning Arabs against the U.S. And the Administration's "with us or against us" anti-terror campaign is putting American allies such as Egypt and Saudi Arabia on the defensive. These are all reasons why the Middle East is likely to remain fertile ground for militant groups. And the new generation of extremists could make Osama bin Laden look tame.

To be sure, last fall's events have sparked some self-criticism in the Arab world. On Dec. 30, Saudi Arabia's Crown Prince Abdullah delivered a harsh lecture to a regional summit meeting in Muscat, Oman. He called for an end to the time-honored practice of blaming the region's shortcomings on outsiders. Others are also pondering the roots of the September 11 attacks. "It is up to the Islamic world to return to its senses and

assess the damage [Osama bin Laden] has caused," wrote Khalil Ali Haider, a specialist on Islamic groups, in the Kuwaiti newspaper *Al-Watan*.

Slowly, Saudi Arabia and Kuwait are stepping up the pressure on militant Islamists. The governments are curbing Islamic charities that have funded violent groups. They are reviewing school curriculums, which have become overly religious in content. But such moves don't go far enough. The roots of Islamic extremism lie not so much in religion but in repressive societies with economies too anemic to provide livelihoods for their fast-growing populations. Despite much talk of reform, most Arab countries remain museums of state capitalism. "Those who expect a new, reformed Islam are asking the wrong questions. We don't have a Luther. We don't have a Calvin," says Tahseen Bashir, a former Egyptian presidential spokesman and diplomat. Instead, they have suicide bombers, who appeal to Middle Easterners for having the guts to stand up to big powers.

And what is the U.S. doing? The Washington hasn't unveiled a long-term based strategy for the region. In the single-minded focus on terrorism has contributed to the Administration abandoning long-standing U.S. efforts to broker peace between Palestine and Israelis. "There is no longer a process. In this new situation hope is being replaced by despair," says Mohamed Sid Ahmed, a columnist with the Cairo daily *Al-Ahram*.

Desperation encourages young people to become suicide bombers. It's the easy way to strike at powerful adversaries. "If the U.S. continues the same policy toward the Arabs, it will give terrorist movements a new life; they will be stronger than today," warns Diwan, a specialist on these groups.

Al-Ahram Center for Strategic Studies in Cairo thinks repression will work for a while. But unless there is hope, the Middle East could become a cradle of more dangerous groups.

By Stanley
in L



TINY STEPS TOWARD PROGRESS IN THE MIDDLE EAST

REGIONAL INSTABILITY

Declining living standards and fallout from the Arab-Israeli dispute could produce more turbulence.

SUPPRESSION OF ISLAMIC GROUPS

Governments realize that extremists are dangerous. But they could go underground or offshore.

GRADUAL ECONOMIC OPENING

Governments will have little choice but to try to attract investment—but don't expect fast results.

GLACIAL POLITICAL CHANGE

Regional governments excel at one thing—keeping power. They will only share it reluctantly.

Data: BusinessWeek



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COMMENTARY

By John Carey and Ellen Licking

THE STEM-CELL DEBATE JUST GOT THORNIER

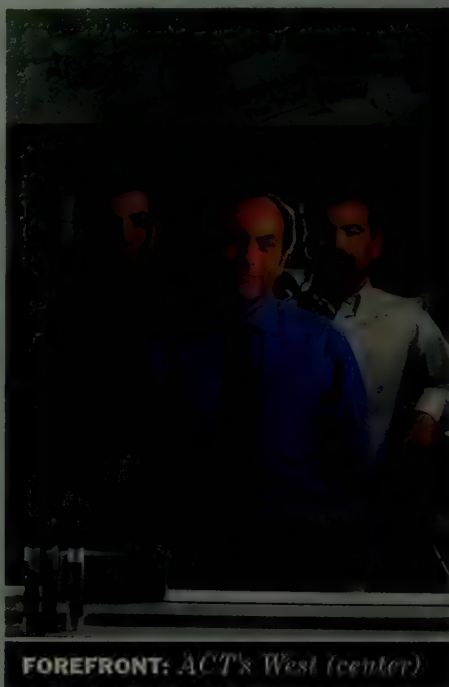
Versatile stem cells are biology's answer to a blank canvas on which many wondrous scenes can be painted. Blessed with the ability to become any tissue of the body, they have the potential to restore a failing heart, tame the tremors of Parkinson's, cure diabetes, or treat uncounted other ills.

There's an enormous catch, however. One of the best ways to obtain stem cells is to strip them from a human embryo—destroying it in the process. It's no surprise, then, that the Bush Administration has banned the use of federal research dollars for work using stem cells created through the destruction of additional embryos, nor that Congress is considering a ban on cloning, which could someday offer a bounteous source of such cells.

But as Congress debates the emotionally and politically charged issues of embryonic stem cells and cloning, science is forging ahead with extraordinary speed. Now come new findings that may offer a way around any restrictions lawmakers impose, while raising even deeper questions for ethicists to ponder.

In late January, scientists at the University of Minnesota revealed that cells from adult bone marrow can match the ability of embryonic stem cells to turn into nerves, muscle, liver, and other specialized tissues. And in the Feb. 1 issue of *Science*, a team of corporate and academic researchers reports that unfertilized monkey eggs can be induced to provide stem cells with similar amazing potential. If the same process works in humans, "it creates an ethical alternative [to using embryos] that people can be comfortable with," says Kent E. Vrana of Wake Forest University School of Medicine, an author of the *Science* report.

Some foes of embryo research agree. "Many of us have said we would support stem-cell research that does not result in the destruction of embryos," says C. Ben Mitchell, a senior fellow at the Center for Bioethics & Human Dignity, a Christ-



FOREFRONT: ACT's West (center)

ian-backed nonprofit in Chicago.

Yet ethicists warn that the latest results pose fresh dilemmas. If a stem cell, regardless of its derivation, can be transformed into any type of cell, then it theoretically has the potential to create a human. So, asks Arthur Caplan, director of the Center for Bioethics at the University of Pennsylvania, does that make it the functional—and moral—equivalent of an embryo?

While politicians and ethicists argue, the science continues to advance. Witness the recent work of Dr. Catherine Verfaillie at the University of Minnesota, who demonstrated the enormous flexibility of certain adult cells. Verfaillie extracted cells from bone marrow, grew them in petri dishes for up to two years, and showed that they could turn into everything from liver and cartilage to brain cells.

The work reported in *Science* takes a different tack. Researchers at Advanced Cell Technology (ACT) in Worcester, Mass., and several academic centers start with eggs from female monkeys. Bathed in a chemical soup, then zapped with jolts of elec-

tricity, the eggs begin developing into embryos, a process known as parthenogenesis.

At ACT, embryos created in this fashion haven't survived for long. A few have reached the blastocyst stage, consisting of about 100 cells. That's enough for ACT's researchers to extract some of the inner cells and create a long-lived line of stem cells capable of being transformed into many different types of tissue. "We found hard tissue, smooth muscle, hair follicles, pigmented epithelial cells, and gut cells," says Wake Forest's Vrana. In one experiment, a proportion became brain cells that produce a chemical called dopamine, precisely the type of cell that is damaged by Parkinson's disease. "That's spectacular," says Michael D. West, president and CEO of ACT. "No one has seen that before."

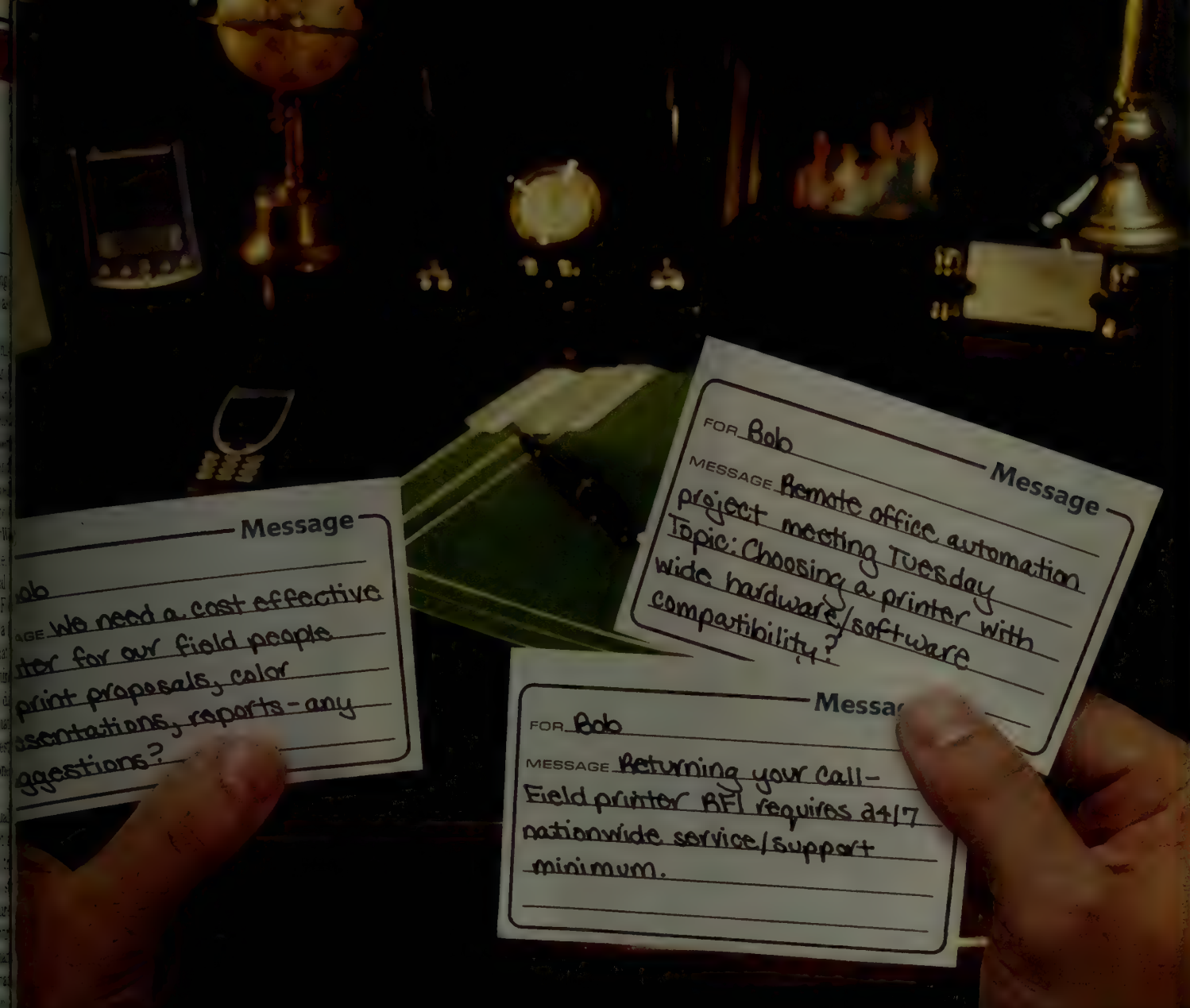
The potential is huge. Eventually, scientists may be able to extract an egg from a woman, jolt it down the path toward an embryo, extract stem cells from it, and use them to cure ailments. The cells would have virtually the same genes as the woman's own, so they could be injected back into her without risk of rejection. "We could make anything a woman needed," West says. "Young blood cells or heart cells or neurons—that is the dream." Males would be trickier, but ultimately possible, he says.

That is, if the procedure can leap all the hurdles: scientific, political, and moral. "Are parthenogenetically created embryos biologically identical to other kinds of embryos?" asks Mitchell. "This is a discussion we need to have." Perhaps tricking unfertilized eggs into becoming embryos for research will prove as morally pugnacious to right-to-lifers as using old-fashioned kind. After all, says biotech foe Jeremy Rifkin, president of the Foundation on Economic Trends, "you are still talking about an embryo." But by the time politicians resolve that question, scientific discoveries are bound, once again, to shift the debate to a whole new level.

Carey and Licking cover science from Washington and New York.



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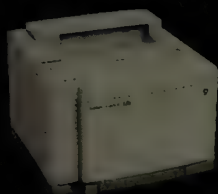
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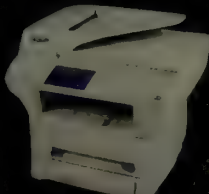
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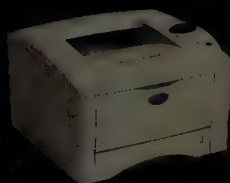
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ESPN'S FULL-COURT PRESS

Ratings are down, so the network is going all out for new sources of revenue

Heading into last fall, ESPN President George W. Bodenheimer knew his 22-year-old sports network needed a jolt. The ad climate was abysmal, ratings were soft, and cable operators were sniping about the hefty fees ESPN charges for airing the network's fare. So when the chance came up around Thanksgiving to bid on the rights to broadcast National Basketball Assn. games, Bodenheimer jumped. On Jan. 22, he announced that, along with ABC, a sister unit of Walt Disney Co., ESPN had outbid NBC for six years of NBA games. The price tag: \$2.4 billion, or just over a year's worth of ESPN revenues.

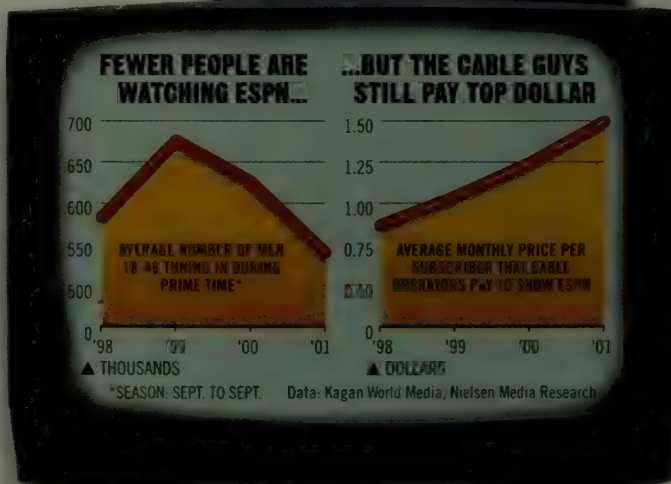
The deal could be ESPN's riskiest bet yet. While the network reaches 86 million U.S. homes, it finds itself among cable TV's once-hot, now-maturing brands such as MTV and CNN. In prime time among the coveted audience of males 18 to 49, viewership is down 14% in the past year. Its rival, Fox Sports Net, is up 12% in the same group. "It's not all about ratings," insists the 43-year-old Bodenheimer, who started at ESPN in 1981 driving on-air personalities to and from ESPN's Bristol (Conn.) headquarters and nearby Bradley International Airport. "They're not the sole value of a company our size."

Still, the ratings slide isn't the only trouble spot. ESPN charges one of the highest fees to cable and satellite operators for its programming. That has brought long-simmering resentments between ESPN and its distributors to a boil. "The fees are outrageous," says one senior cable exec. "It's really soured the entire industry against them."

ESPN is hoping the NBA deal will ease the operators' pain—though that's not a given. Basketball is a sport that has



BODENHEIMER: NBA games, wireless services, and interactive TV



seen its TV ratings plummet 40% since 1996. And ESPN's NBA foray is the first time a cable player has grabbed a major sports contract from the broadcast networks. NBC, which had held the contract for the past 12 years, refused to shell out more than \$1.3 billion, after losing money in two of the four years on its last contract. Bodenheimer says he's confident of a ratings resurgence and figures the price will turn out to have been well worth it. That's because ESPN and ABC together will be able to broadcast many more games than NBC's 32—75 regular-season contests, mostly on ESPN and ESPN2—and ultimately sell more ads.

Complementing the NBA deal is another new arena for ESPN: original pro-

gramming, including made-for-TV. On Mar. 10, the ESPN-produced *son on the Brink: A Year With Knight and the Indiana Hoosiers* make its debut on the network. Brian Dennehy starring as the hyper coach. A late-night sports show hosted by actor Jay Mohr away from Fox Sports Net, will go off in April. "It's a smart move, economically to begin to integrate sports with programming it pays for," says consultant Neal Pilson, a president of CBS Sports.

ESPN is also looking for new revenue by expanding beyond its stalwart work. Already, it has six other channels, a radio network, a Web site, *ESPN The Magazine*, and Zone restaurants. The latest venture is an interactive channel on DirecTV that allows viewers to grab news scores with a flick of the remote. And its wireless unit is charging for scores and news it delivers on phones, personal digital assistants, even to scrolling screens atop New York's fleet of yellow cabs.

Still, Bodenheimer's growth won't count for much if he can't

ensions with cable and satellite operators. They accuse ESPN and parent of squeezing them on price, since of their subscribers consider ESPN ple of their service. On average, charges operators \$1.50 a subscriber per month—more than twice CNN charges. And ESPN contracts or 20%-a-year increases. Says Jernt, former chief executive of cable for Charter Communications Inc.: is a virtual monopoly. Backed up ney, it has a gun to the heads of operators."

ne companies aren't taking it. es W. Ergen, CEO of satellite service Star Communications Corp., o perturbed about having to pay a -year fee increase for ESPN Classic, shows old game highlights, that ipped it off his service and threat- to do the same to Disney's Family el. A group of executives, includ- ent, are calling for Congress to e ESPN to offer its service à la just as Home Box Office or Show- Networks Inc. is offered for a pre-

Another complaint: that Disney Michael D. Eisner uses ESPN ag- vely in negotiations to make cable ns carry Disney's other, less- ed channels. But by doing so, one exec says, he's hurting ESPN. "He's the golden goose," he says. Coun- lodenheimer: "Consumers are vot- their wallets."

Meanwhile, the competition isn't ex- sitting still. Five-year-old Fox s Net is trying to break the ESPN by putting more emphasis on re- and local sports, hoping to at- the less-hard-core fans, says Fox Net President Tracy Dolgin. And time Warner Inc.'s Turner Broad- g System Inc. struck a \$2.2 bil- ix-year pact to broadcast 52 regu- sation NBA games a season, as well partnership with the NBA to launch all-sports cable channel.

When does Bodenheimer start to ? Maybe not until his ratings gu- ell him bowling tournaments are g out the NBA.

By Tom Lowry in Bristol, Conn.



FOR-TV MOVIE: Brian Dennehy the Hoosiers' Bobby Knight

THE OLYMPICS

TRADING DESK HERO?

Aelin Peterson's unusual trek to a U.S. Olympic ski team

When the Winter Olympics kick off on Feb. 8, there will be the usual suspects to root for. Sequined ice queens. Cool-dude snowboarders. Burly hockey players named Igor or Jacques. But whom should the hardworking, unemployment-fearing suits and pantsuits of Corporate America cheer on? Whom can the masses of stressed-out Palm Pilot slaves relate to? Whom can The Street call its own?

Meet Aelin Peterson, a former eat-at-your-desk equities trader who got flabby as hell and chose not to take it any more. So Peterson pushed herself away from three computer screens and a \$65,000-a-year paycheck—with much more to come—and made the U.S. Olympic cross-country ski team.

Raised in a tiny Alaskan village, Peterson learned to skate on the frozen Bering Sea—and ski cross-country. By high school, her family had moved to Fairbanks, where she became a teenage standout. At Northern Michigan University, Peterson majored in economics and made it to the World University Games. But a bout with viral meningitis and competitive burnout seemed to end her career at age 20. "My body was just done," says Peterson, now 27.

On to Boston she went as an intern at Brown Brothers Harriman & Co., the investment bank. Peterson was looking to be hired full-time but got to thinking about those days by the Bering Sea. She got an itch to become an Olympic speed skater. "I've always been a risk-taker," she says. Without a job, car, or apartment, she moved to Milwaukee, which has one of the nation's few Olympic-sized skating ovals.

To support herself as she trained, Peterson found work at Milwaukee-based Strong Capital Management, answering calls about Grandma's mutual fund. The

speed-skating lark went nowhere, but within a year she had climbed to a junior trader position, learning at the elbow of Strong's then-trading director, David Braaten. "We look for people with a high level of commitment to do their best and a passion," says Braaten. "Aelin just radiated all of that."

Into the office at 5:30 a.m., she would check foreign markets, scan financial news, and warm up for the day's trading race. "She was our eyes and ears," says Braaten. For three years, Peterson was on a fast track. But something was missing. "I was very unhealthy," she says. "My body told me that I needed racing again." Her mind sent messages, too: "Skiing reentered my life at night. In my dreams, I was racing or training."

Peterson didn't need a shrink to interpret her dreams, and Braaten couldn't



CROSS-COUNTRY GLORY: Peterson after the National Championships

muster a counteroffer. "She told me she wanted to be in the Olympics," he says. "I was astounded. But she had to follow that dream."

Barely 15 months ago, Peterson moved back to Alaska, entered her first race in four years, and finished last. She kept plugging, though, even after running through \$30,000 in savings. By the end of January's national championships, Peterson was the fourth-ranked woman in America and earned one of eight spots on the U.S. Olympic cross-country ski team.

"How many working women are able to take a risk like this?" Peterson asks. "I know I've been given a luxury. But if other working women have some unfulfilled goals that have been sadly tucked away, I would like to think that they would see me and take a shot at their own dreams."

Or, at least, root for Aelin Peterson, who may have made the most profitable trade of her career: stocks for—could it be?—a precious medal.

By Jay Weiner in Minneapolis

TELECOM LENDERS: STANDING IN LINE FOR WHAT?

Banks, without the protection of being first to be repaid, face billions in loan losses

Not even the world's largest commercial banks were immune from the telecom investment craze. As the mania peaked in the late 1990s and early 2000, the gray-flannel crowd at Citigroup, J.P. Morgan Chase, Bank of America, and elsewhere behaved with all the abandon of day traders. Banks issued more than \$320 billion in loans to the telecom industry between 1999 and 2001.

Now, the banking system faces billions in losses. On Jan. 28, Global Crossing Ltd. became the latest in a series of

once-promising start-ups to take refuge in bankruptcy court, joining the likes of 360networks, Teligent, and Winstar. When they filed, those four carriers owed at least \$5.25 billion to the likes of J.P. Morgan, Citi, and Bank of America, which in turn sold the debt to dozens of other banks. "You assume bankers have this great font of wisdom, but they're human like anyone else," says Hugh Ray, partner and head of bankruptcy practice at Houston law firm Andrews & Kurth LLP. "They got really caught up."

In hindsight, it was a disaster waiting to happen. By the time the banks arrived on the scene, bondholders had beaten them to the punch and struck agreements ensuring they'd get

paid first if a telecom company failed. The banks often failed to obtain meaningful collateral on their loans, which were sometimes secured by shares that are now nearly worthless.

These days, pretty much the entire emerging telecom sector is either in bankruptcy or beset by critical financial problems. Xo Communications, which has \$4.5 billion of debt, including a \$1 billion credit facility, is attempting to restructure its liabilities. If it fails, one insider says, the company probably will have to file for bankruptcy. In the worst case, the banks' losses could rival the \$150 billion hit the

industry took during the dot-com boom.



of a decade ago. At least this time and, the banks have bigger reserves than—and their lending is more diversified. But there's no question that telecom losses will force banks to take billion-dollar write-offs and lower future earnings.

The outlook for Global's creditors is good. No one knows how much bondholders or banks will receive after investors Hutchison Whampoa Ltd. Singapore Telecom take control. They have only offered \$750 million, "that does not leave a lot of cash for creditors," says Aryeh Bourkoff, a

analyst at UBS War-

Global's chief financial officer, Dan J. Cohrs, says he fully expects that creditors will demand changes to the proposed restructuring. Already, Global's filing spooked investors who rushed to dump shares of their telecom carriers. In Jan. 29, Williams Communications and Tyco International, a conglomerate that operates undersea telecom networks, both plummeted 20% while WorldCom

troubled began after the telecommunications Act of 1996, which started a \$1.3 trillion avalanche of lending by investors and bankers

to finance a host of upstarts that supposedly take on Verizon Communications, AT&T, and other established carriers. Among the upstarts, I got an extra boost because my brother Gary Winnick was one of Wall Street's own. Having risen through the ranks of junk-bond pioneer Michael Milken's shop, Drexel Burnham Lambert Group Inc., he could open doors. "A year ago, I could just pick up the phone, have a conference call, and raise a billion dollars. Times have changed," says Global's Cohrs.

The dream was shattered by a series of setbacks. Internet traffic was expected to grow 75% a year, supporting dozens of new carriers. But those predictions didn't foresee the sudden col-

lapse of hundreds of Internet companies or an approaching downturn. Today, the growth rate for Net traffic is about 30% to 40% a year. The overoptimistic assumptions wreaked havoc with many a start-up's business plans, says Cohrs.

Mounting debt finally forced carriers into bankruptcy. Faced with insufficient revenue growth, they had to borrow money to build new networks or update old ones. Global, with \$3.4 billion in revenue, owed a crushing \$7.5 billion, on which it had to pay \$600 million in interest and \$200 million in preferred dividends a year. It wasn't unique. Lots

of companies were borrowing money to cover losses incurred in building massive networks. "Telecom had \$60 billion in negative free cash flow in 2000, by far the largest amount of any industry in modern times," says Lehman Brothers Inc. analyst Blake Bath. He expects the industry to turn cash flow positive this year. Meanwhile, dozens of companies like Global have declared bankruptcy because investors stopped funding their losses.

Most upstarts got their initial funding from venture capitalists, and then rushed to an initial public offering even before they had steady cash flows or profits. Then, they tapped the junk-bond markets for additional funding. Only after the companies had large market cap-

italizations and well-known names did the banks decide it was safe to finance them. But the high-yield bond underwriters, led by Salomon Smith Barney, had already staked out their position—and structured their deals so that they would be the first in line to be repaid if a telecom company went under.

The banks and bondholders will fight among themselves, too. Traditionally, banks are entitled to foreclose on a physical asset, such as a factory or a piece of equipment, if a loan goes bad. But in Global's case, lenders such as J.P. Morgan and Citi have no lien on the company's 100,000-mile network, which spans 27 countries and the world's major oceans. Their only claim is on the battered shares of the 100 or so subsidiaries that own the network. Bondholders, meanwhile, own a piece of Global Crossing's assets, including its subsidiaries. Look for a "giant pissing match between bank lenders and bondholders," says one telecom banker. Right now, market players are betting the banks will prevail in the end despite their lack of formal claims. That's why Global's bonds are currently trading at 9¢ on the dollar, while its bank loans fetch 40¢.

Creditors will fare just as badly in other telecom bankruptcies. For example, 360networks' \$1.2 billion in bank debt was lent with the understanding that it would be backed by whatever asset the company bought with the money. Those assets—mostly fiber-optic communications systems—are worth just pennies on the dollar, leaving hardly enough to pay back even one creditor. The banks seem to be in a better position with Winstar Communications Inc. because they were able to secure first claim on the carriers' assets. The problem? On Jan. 24, IDT Corp. said it would buy Winstar out of bankruptcy for \$24 million. That's equivalent to less than a penny on the dollar for Winstar's \$8 billion of outstanding loans, bonds, and equity—so its bank creditors are first in line to get next to nothing.

The Winstar case should be a wake-up call. Some creditors fear that the worst is yet to come for Global Crossing because there's no guarantee that its restructuring will be approved by creditors or the courts. Indeed, Global and other failed telecom carriers such as 360networks could be lucky just to avoid liquidation.

By Steve Rosenbush and Heather Timmons in New York

THE MONEY PIT

Banks and investors have lent \$1.3 trillion to telecom companies since 1996. Some of the biggest borrowers are now in serious trouble.

COMPANY	AMOUNT BILLIONS		LENDERS
	BANK LOANS	BONDS	
GLOBAL CROSSING	\$5.9		J.P. Morgan Chase, Goldman Sachs, Citigroup
		\$2.3	Fidelity, Met Life, Franklin Advisers
MCLEOD USA	3.9		J.P. Morgan, Citigroup, Goldman Sachs
		1.4	Franklin, MetLife, SunAmerica
360NETWORKS	1.2		J.P. Morgan Chase, CSFB, Toronto Dominion
		0.2	Putnam, McKay Shields, J&W Seligman
WINSTAR COMMUNICATIONS	0.8		Bank of N.Y., ABN Amro, Scotiabank
		0.7	Morgan Stanley, Putnam, Cigna

Data: Thomson Financial, Capital Access





VENTURE CAPITAL

'THERE WAS NOWHERE TO GO BUT UP'

After a long lull, VCs are opening their wallets

Corey S. Goodman, chief executive of Renovis Inc., a 45-person biotech outfit near San Francisco, is feeling pretty good about the prospects for the psychiatric drugs that his company is developing. On Jan. 9, the neuroscientist's two-year-old company raised \$34.3 million in venture financing, more than twice its take in a prior round. What's more, the funding means that Renovis is worth more than \$40 million, or 40% more than in July, 2000—when it got its last chunk of venture cash.

What gives? Late last year, in tandem with the 33% rebound in the Nasdaq since its post-September 11 low, U.S. venture capitalists loosened the purse strings for the first time in four quarters. Experts say firms have written off much of the deadwood from the Internet frenzy and are under pressure from their investors to spend the \$51 billion that has been lying fallow for the last two years. "People have wallets so

thick that they're leaning to one side," says Gilbert H. Kliman, a partner at Inter West Partners in Menlo Park, Calif.

It's not that venture capitalists are putting more total dollars to work. It's that they are putting more money into the most promising deals, many of them in the healthcare sector. That is pushing up valuations—the worth of an entire company based on the price the VCs pay for the shares they get. According to researcher Venture Economics, the median valuation for private biotech outfits grew 55%, to \$52.5 million, in the final quarter of 2001 from the pre-

vious quarter and 41% from a year earlier. In the fourth quarter, the median valuation in life sciences rose from \$30 million the quarter before to \$50 million while for IT companies, it grew a more modest 15%, to \$32 million. "If life signs are there," says Venture Economics Vice-President Jesse E. F.

The data are encouraging. But experts caution that such figures should be viewed as no more than signs that venture funding may have finally bottomed. "It's not the beginning of a bubble," says Tracy T. Lefteroff, managing partner for private equity at PricewaterhouseCoopers. "Rather, it might be the beginning of an upturn. Things had gotten so gloom-and-doom that there was nowhere to go but up. As venture firms gutted out a unprecedented four straight money-losing quarters, they scaled back investments from a high of \$91.6 billion in 2000 to \$32.1 billion last year, says San Francisco's VentureOne Corp.

Biotech and life sciences startups are leading the uptick, in part because of breakthroughs in genetics research. Health care's share of the venture market swelled from 9% in 2000 to 17% in 2001, according to VentureOne. Companies such as Renovis, for example, use cutting-edge genetic technologies developed at top universities. And its founders include well-known scientists such as Chiron's co-founder Edward E. Penhoet. The success reflects in large part the ability and reputation of our private sector technology, and our goals, says Goodman.

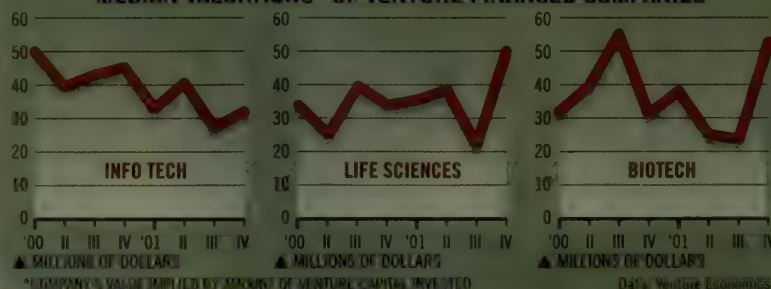
Some Internet-technology startups that fill that bill are getting funded. Jan. 28, Neoteris Inc., a Sunnyvale (Calif.) neophyte, said it had raised \$1 million—more than tripling the company's value, which it won't disclose, in less than a year. Its technology provides secure remote access to corporate networks through Web browsers, a service that became more pronounced following September 11. What's more, CEO Na Kolluri says, Neoteris will be profitable in 2002.

Provided that the market doesn't tank, venture investors expect to pay more for young companies in 2002. "I'm poised to see it," says Chris Ehrlich, a senior associate at InterWest. Entrepreneurs should bank on it.

By Linda Himelstein
San Mateo, Calif.

THE PRICE IS RIGHT

MEDIAN VALUATIONS* OF VENTURE-FINANCED COMPANIES



By Joseph Weber

HARLEY INVESTORS MAY GET A WOBBLY RIDE

For much of the past year, Harley-Davidson Inc. was the stock market equivalent of an Evel Knievel act. With a couple of ups and downs along the way, shares careered between \$32 last spring and a current dizzying \$53. Are they riding a fall again? Troublingly for folks who admire the gleaming, chrome-plated machines, signs are growing that Harley investors could soon suffer another heart-stopper.

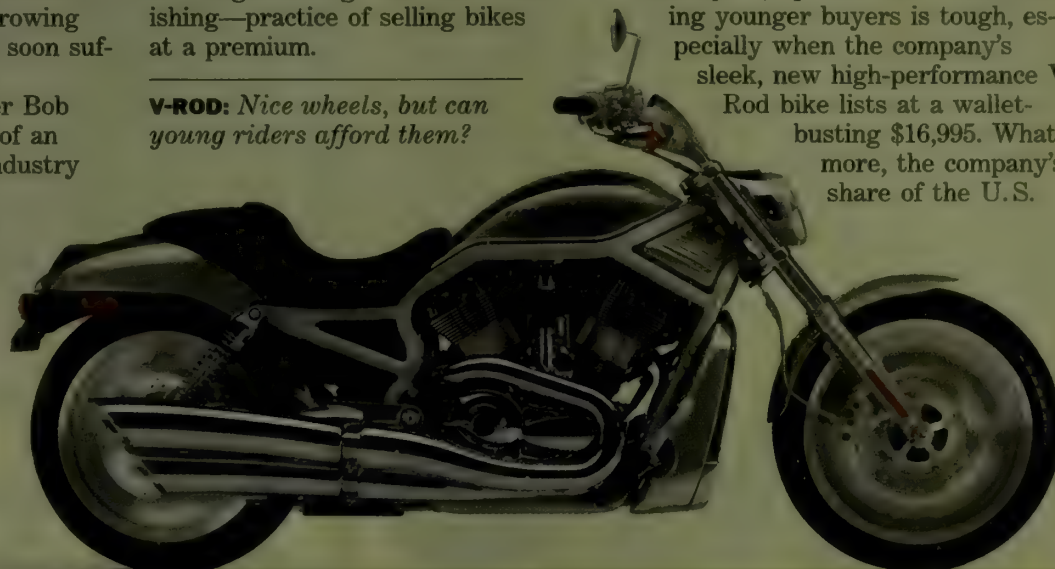
Consider Harley customer Bob Johnson, 52, vice-president of an oil company (Utah) maker of oil-industry products. Back in 2000, when Johnson bought his Softail Fat Boy, he had to wait several months and pay \$16,000 over suggested retail. Even then, he considered himself lucky: In Texas, Harleys were selling for \$4,000 to \$5,000 over list. But last December, he snared an Electra Glide Classic for \$2,000 below retail and rode away on his check-out \$16,770 riding machine. "They had inventory, and they were actually discounting," he crows. Johnson's good fortune may grind the gears for Harley's investors. The marvel of Milwaukee, which roared back from near-ruin in 1986 to dazzle investors and bikers alike with its marketing savvy, financial savvy, and sheer mystique may be facing a patch of rough road. It's losing market share to Japanese rivals such as Honda Motor Co., seeing lower prices for some of its bikes that used to trade at a premium, and facing a peculiar marketing headache stemming from its upcoming 100th anniversary. Buyers seem to be hanging back, awaiting next year's collector-edition models. As dealers in places as far-flung as Illinois, Texas, and Delaware tell it, Harley has been stuffing showrooms with 2002 models in recent months. Partly because it books shipments to dealers as sales, it was able to report seemingly recession-defying 26% growth in 2001 net income, to \$437.8

million, on a 15.7% gain in sales, to \$3.36 billion. After hiking its output last year by 14.6%, it plans to churn out 10% more—to a record 258,000 bikes—this year. Chief Financial Officer James L. Ziemer says Harley wants to "narrow the gap" between supply and demand in order to curb the long-standing—but fast-diminishing—practice of selling bikes at a premium.

V-ROD: Nice wheels, but can young riders afford them?

was close to a year. All of a sudden, for 2002, it just went away," says Howard M. Brown, general manager of Chicago Harley-Davidson, which has 50 unsold bikes.

Even without recession or overproduction, Harley's growth may suffer. The median age of its buyers is nearly 46, up from 35 in 1987. Wooing younger buyers is tough, especially when the company's sleek, new high-performance V-Rod bike lists at a wallet-busting \$16,995. What's more, the company's share of the U.S.



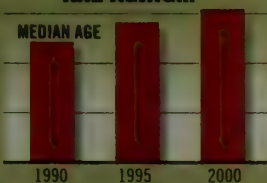
ROUGH PATCH AHEAD?

Chart: Harley-Davidson Inc., Bloomberg Financial Services, Motorcycle Industry Council

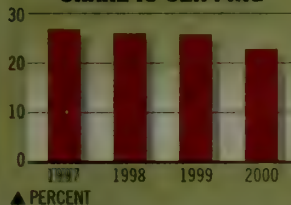
HARLEY'S STOCK PRICE IS REVVED UP...



...BUT ITS CUSTOMERS ARE AGING...



...AND MARKET SHARE IS SLIPPING



Since scarcity has long been part of Harley's appeal, that's quite a change. Even as Harley ramped up production during the 1990s, buyers waited months for their dream machines. The longer the waits, the more Wall Street loved Harley. At about \$53, the stock is worth a dizzying 32 times estimated 2002 earnings of \$1.66 a share, according to Thomson Financial/First Call. Even so, each of the dozen Wall Street analysts who follow the stock has a "buy" or "strong buy," confident Harley can expand earnings 16% this year and a further 15% in 2003.

To hit those targets, Harley's 630 dealers will have to clear out 2002 models by July, when the '03s come roaring in. But buyers aren't clamoring for them. "We had a two-year waiting list at one time. Last year, it

new-bike market has dropped to 23%, down from a 27% peak in 1997 as Japanese rivals make inroads.

With lots of sentiment and image built into Harley stock, even slight hints of trouble can send it into a violent slide. Last spring, shares plunged 25% in seven weeks when word leaked—wrongly, as it turned out—that monthly sales were slipping. Don J. Brown of DJB Associates LLC, an industry consulting firm, is again seeing "a modest decline" in sales on a month-to-month basis. Harley's fans on Wall Street will have to hope that it proves to be short-lived. Otherwise, they may be facing some serious time in the dirt.

Weber covers financial markets from Chicago.

Samuel J. Palmisano was hopping mad. It was October, 1999, and he had just taken over IBM's \$13 billion computer server business. But the computer giant's Unix machines—the technology of choice for the dot-com digerati and the backbone of corporate computing—were pricey and poky. Rivals Sun Microsystems Inc. and Hewlett-Packard Co. were eating IBM's lunch, dinner, and breakfast. "They were killing us," says William Etherington, then senior vice-president of IBM's sales.

So Palmisano went on the attack. He devised a game plan he called "Project Pain." IBM was going to put the hurt on rivals. He assigned his top people to key bids and freed the sales staff to dazzle customers with discounts of up to 70%—untouchable by other computer makers. IBM would make up the lost revenue from the services and software sold along with the servers. And if it took big guns to close a deal, CEO Louis V. Gerstner Jr., Palmisano, and Etherington were ready to board the corporate jet.

The plan worked—a little too well. Fired up by Palmisano's take-no-prisoners approach and a line of powerful new servers, the IBM sales staff went into overdrive. In the first quarter of 2000, IBM hit Sun Microsystems like linebacker Ray Lewis during an NFL playoff game, claiming first place with a 25% share of the market, vs. Sun's 21%. Then IBM hiccuped. The company underestimated demand and didn't have crucial parts to build machines. Again, Palmisano stepped in. He

IBM'S

Sam Palmisano

started the coffee pot every morning at 7 for the managers who stumbled into his office to review the status of every single component—part number by part number. He hit the phone to hound suppliers to speed up deliveries. By the next earnings report, problem solved. "That was a defining moment for Sam," says Etherington. "He'll roll his sleeves up, and he'll just work the thing to death."

Palmisano may never have a chance to roll down his sleeves

again. On Jan. 29, IBM's board named him the eighth CEO in the compa-

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ny's 91-year history. He officially takes over on Mar. 1, when Gerstner's contract expires. Managing IBM—bigger and broader than any other tech company—is perhaps the most challenging job in the industry. And while Big Blue is in its best shape in a decade, Palmisano steps in just as the industry is reeling. For the first time, PC demand is shrinking, economic malaise has dried up corporate spending, and tech players are scrambling to come up with the Next Big Thing that might spark a rebound. Is Palmisano, now IBM's president and chief operating officer, daunted? "The industry was tough last year, but we're spot-on with our strategy," says Palmisano. Gerstner will stay on as chairman until the end of the year, although he insists Palmisano "doesn't need to learn a lot from me."

Indeed, Palmisano may be just what Big Blue needs after Gerstner. Although he is an IBM lifer with 28 years under his belt, he's not the typical Big Blue exec. Instead of making

NEW

has a tough act to fo

THE CEO HERITAGE

THOMAS J. WATSON



FOUNDER
AT AGE 40

TENURE
1914-56

The founding father who built IBM to sell clocks, scales, and punched-card tabulators.

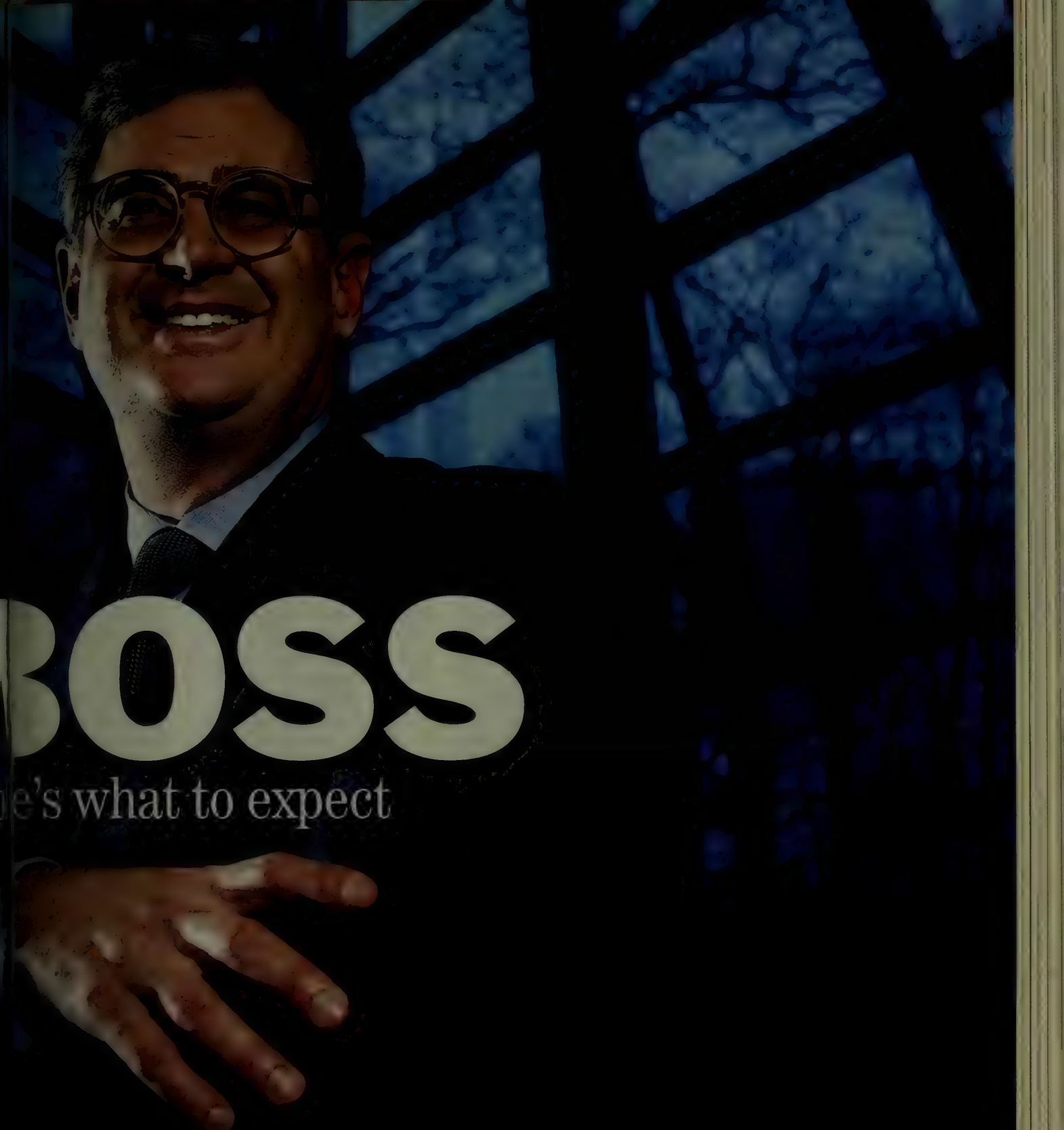
THOMAS J. WATSON



APPOINTED
AT AGE

TENURE
1956-

Shepherd into the Computer



BOSS

he's what to expect

PEARSON

APPOINTED
AT AGE 58

TENURE
1971-73

Streamlined
ization,
parate
sales and
ing.

FRANK T. CARY

APPOINTED
AT AGE 52

TENURE
1973-81

Tripled
revenues and earnings
even as IBM's share of
the computer business
fell by half, to 32%.

JOHN R. OPEL

APPOINTED
AT AGE 56

TENURE
1981-85

In a golden
era for IBM
mainframes, he
doubled revenues.

JOHN F. AKERS

APPOINTED
AT AGE 51

TENURE
1985-93

Ousted by
the board after racking
up billions in losses.
He wanted to break up
the company.

LOUIS V. GERSTNER JR.

APPOINTED
AT AGE 51

TENURE
1993-2002

Engineered
IBM's turnaround,
remaking the company
into a services
powerhouse.

SAM'S TO-DO LIST

safe bets, he has repeatedly challenged old thinking and taken risks. That brash style could be key when the upturn begins and computer makers refashion themselves to heed customers' demands. Palmisano's past may play to a turbulent future: In 1993, he questioned management's view that IBM's nascent services business didn't need to turn a profit on deals for several years. Not only did he make

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sure deals made money on Day One but he also insisted they be multimillion-dollar contracts. Last year, services contributed 50% of IBM's pre-tax profits. In 1999, he pushed for the company to exit the money-draining consumer PC business. And he has been the chief advocate behind IBM's \$1 billion push into Linux software, a radical move away from IBM's tradition of selling proprietary operating systems.

Does Gerstner worry that Palmisano might be too bold for tried-and-true Blue? "I hope he throws out everything that I ever went for and he goes for a new strategy," says Gerstner, laughing.

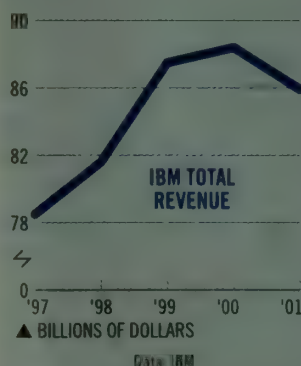
Gerstner may be laughing, but Wall Street isn't. On Jan. 29, IBM's stock price dropped \$5.15, or 5%, to \$103 a share. That was on a day with a broad sell-off in stocks. It bounced back a bit the next day, hitting \$105.55. Still, analysts worry that while Palmisano is an operations whiz, he may not be able to match Gerstner's skills as a strategic thinker. "Does he have the strategy chops to lead IBM the way Gerstner has?" questions analyst Steve Milunovich of Merrill Lynch & Co.

In the short term, that won't be put to the test. Palmisano says IBM's strategy of emphasizing services to help buyers cope with gaggles of complicated technology is a winner. Instead, his first order of business is tackling execution—namely, better managing IBM's three problem children: PCs, disk drives, and semiconductors. IBM's PC and printer business lost \$153 million last year, while storage and chips hemorrhaged \$374 million. One way to cut costs in PCs is to sell more machines over the Internet, doing away with costly

GOOSE GROWTH

LOU'S LEGACY When Gerstner took over IBM in 1993, the company had lost \$16 billion over the three previous years. In 1994, IBM posted a 6% revenue gain. It kept growing, averaging 5% sales growth over the next seven years.

SAM'S CHALLENGE In the last two years, IBM's growth has stalled. In 2000, revenue grew 1%. IBM sales declined 3% last year and fell 11% in the latest quarter. True, Big Blue has fared better than rivals. But when the economy picks up, so must IBM to reach its goals of high-single-digit growth for revenues.



SMOOTH EXECUTION

LOU'S LEGACY Before Gerstner, IBM was a lumbering giant unable to execute quickly. It's still far from being a tech speedster, but it's a lot more responsive than it used to be. These days, IBM introduces a new Unix server every 12 months instead of every 2 years.

SAM'S CHALLENGE Apart from services, there are always one or two parts of the company that stumble. Nowadays PCs, storage, and semiconductors are trouble spots. In PCs, for example, IBM's cost structure is too high. It has outsourced production of desktops, but it may have to outsource laptops, too, or slash jobs.

sales teams. Today, about 50% of IBM's U.S. PCs are sold over the Web. "We've made good progress, but we need to go further," says Palmisano.

Palmisano aims to drive costs down across the board at IBM. He's hoping to do that by tapping further into the power of the Web, using it to buy and sell, link withpliers, and develop products—saving time and money. Last year, IBM purchased about \$45 billion of its good and services—some 90%—over the Net, saving \$400 million. Only 25% of IBM's products and services were sold online last year, saving \$500 million. "You will see us continue to drive our productivity and effectiveness" through the Web, says Gerstner.

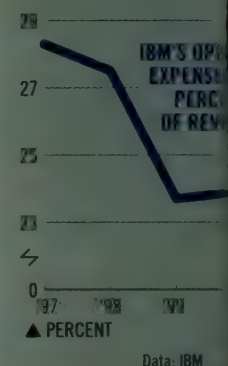
Palmisano must contend with concerns over the quality of IBM's earnings. Critics say that IBM's earnings have been puffed up by booking nonoperating gains from stock buybacks, an overfunded pension fund, and the sale of assets. Tool-Reed, director of corporate ratings for Standard & Poor's, however, says that IBM is financially sound because it generates cash and has a conservative balance sheet. Last year, IBM generated more than \$7 billion in free cash flow, a measure of operating cash flow minus capital expenditures.

Then there's IBM's perennial growth problem. When Gerstner arrived at Big Blue in 1993, the company had suffered the

CUT COSTS

LOU'S LEGACY Gerstner cut operating expenses from 37% of revenues in 1993 to 23.8% last year. The move to gain efficiencies. Last year, IBM cut about \$45 billion in goods and services over the Net, saving \$400 million.

SAM'S CHALLENGE Progress has stalled. Though operating expenses were briefly down to 22.5% of revenue in the fourth quarter of 2000, they're back up to 25% this quarter. While IBM buys more over the Web, it still spends 25% of its goods and services online.





tech giant's future. Today, the \$35 billion Global Services unit does everything from consulting on the design of corporate systems to running tech operations for AT&T. IBM's service-heavy business model is the envy of the industry. Services account for 40% of IBM's revenue, compared with 17% for EMC and 20% for Compaq. "I'm jealous," confesses Compaq CEO Michael Cappelas. "Have you noticed that they've skirted through the downturn?"

Skirted, but not skipped. In the most recent quarter, services revenues declined for the first time due to the recession, to \$9.06 billion, down from \$9.19 billion in the year-ago quarter. Worse, services is people-intensive, which means if the downturn is protracted, IBM's 150,000-person services organization is vulnerable.

Palmisano isn't worried about that possibility. Instead, he's preparing IBM's services group to take advantage of computing's next wave: delivering technology over the Internet much like a power company dishes up electricity to its customers. In tech parlance, it's called "computing on tap." IBM is investing in technologies that automatically find and fix flaws on the Net so tech services are not disrupted. "Even in the tough environment we had in 2001, we continued to invest in those future growth businesses," says Palmisano.

Experts say Palmisano's priorities are right, but much depends on execution and how quickly customers move to computing on tap. "We're coming into a period where it's about growth," says Neil Isford, CEO of Web consultant Plural Inc., who worked for Palmisano at IBM. "Sam's completely suited to that. The guy is a salesman at heart."

The IBM Palmisano inherits is more solid than it has been in years. In 2001, it earned \$7.7 billion on sales of \$85.9 billion. Revenues fell 3% last year, but IBM looks like granite next to rivals such as Sun, whose sales tanked 25%. "They are fantastically positioned for the future," says Rosabeth M. Kanter, a professor of business administration at Harvard Business School.

What gives Palmisano a leg up is that he helped put IBM in this cushy spot. He joined Big Blue out of college and has managed every major division save software and microelectronics. Like pre-Gerstner CEOs, Palmisano rose through the sales and marketing ranks. But in the past eight years, he has managed PCs, servers, and services, which was by far his greatest success. He further sharpened his management skills after becoming president and chief operating officer in September,

SITE SERVICES

GACY Gerstner IBM into a tech-powerhouse. With on in revenues contract backlog of billion, IBM Global contributed 40% \$85.9 billion in and 50% of its billion in pre-tax 2001.

CHALLENGE For the IBM's services fell in the fourth to \$9.06 billion 19 billion a year IBM must sign up all-to-midsize rs and get ahead ext shift in corpo-putting: delivering gy as a utility-like vice.

PICK HARDWARE HOT SPOTS

LOU'S LEGACY Gerstner's faith in the mainframe paid off as e-commerce drove sales of Big Iron. For the first time since 1989, IBM's mainframe business grew in the fourth quarter. Gerstner invested wisely in high-end server technology and became a custom-chip supplier to the rest of the industry.

SAM'S CHALLENGE He must stay a step ahead of rivals in the server business while extending the life of the mainframe. To do that, he must find a way to push mainframes as a less expensive alternative to buying scores of smaller servers.

three years of declining revenues. He dumped manufacturing plants, closed offices, and focused on services. Over the next eight years, IBM grew, on average, 5% a year. Under Gerstner's tenure, if an investor had put \$10,000 into IBM it would be worth \$73,400 today. But IBM has slowed with the times. In 2000, it grew 1%, while sales declined 3% last year. That's better than most

but nothing to be proud of.

misano must get the engine revving again. The emphasis is on software and services, potentially high-growth sectors. IBM's \$13 billion software business grew, on average, 3% a year over the past decade. That's measly compared with Oracle and Microsoft Corp., which have achieved growth rates of up to 30%. To reach those heights, Palmisano will have to share more in markets such as databases and fix the ailing Lotus Notes business—collaborative software that customers say doesn't work well on the Web. "They are not a driving force," says Hasso Plattner, CEO of rival SAP. Where IBM is dominant is in tech services. The hallmark of Gerstner's remarkable turnaround of IBM was his decision to take the company away from its roots as a hardware maker. Now, services is the business that's most crucial to the

BOOST SOFTWARE

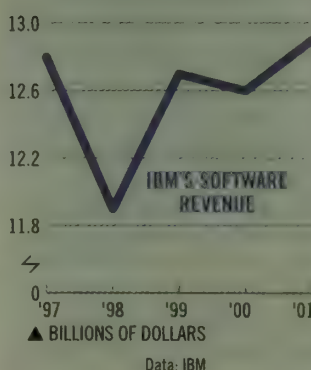
LOU'S LEGACY The 1995 purchase of Lotus Corp. didn't make IBM a big application-software maker. But in late 1999, Gerstner emphasized heavy-duty software such as databases and server programs. And IBM's WebSphere server software, which dishes up e-commerce programs, is No. 2 in the market.

SAM'S CHALLENGE Despite some bright spots, IBM's software division has averaged only 3% growth since 1993 and has fallen to No. 2 in software from No. 1. Palmisano will have to make his \$1 billion bet on Linux software for big corporate jobs to pay off.

SERVICES
REVENUE ANNUAL
GROWTH RATE

1997: \$19.3 BILLION
2001: \$35 BILLION

Data: IBM





PALMISANO'S MANAGEMENT STYLE

BOLD BOSS

While IBM execs are known for taking moderate steps, Palmisano is bold. He backed IBM's exit from the consumer PC business. And he has been the primary advocate behind IBM's \$1 billion investment in Linux software, a radical move away from the company's history of proprietary computer operating systems.

DETAIL

DEMON He doesn't believe in forecasts longer than a week. When he became president, IBM's monthly operations meeting went weekly. Big Blue had to build new information systems to handle the stepped-up time frame. Instead of reviewing 90-day sales forecasts, he asks managers what business they plan to close in a week. He requires a weekly e-mail on how they did.

MAKES THE TOUCHDOWN

Goals are paramount. When Palmisano headed the Personal Computer Div., he was struggling to make his numbers for the fourth quarter of 1997. So he turned up the heat on his worldwide sales team. Starting on Dec. 26, Palmisano insisted on holding conference calls twice a day, at 7 a.m. and 9 p.m., and every day until month's end. He made his sales goal.

CUSTOMER-OBSESSED

Customer needs are No. 1. When the office of Franklin-Templeton subsidiary Fiduciary Trust was destroyed on September 11, Palmisano made sure Fiduciary got all the tech gear it needed. IBM even sent one of its employees to a hospital to check on a missing employee. "You won't find a more customer-focused guy," says Franklin co-President Al Gula.

HATES

MEETINGS He keeps meetings to 15 minutes and tries to schedule them in the early evening when business winds down. When he headed outsourcing, Gerstner put him on a task force to meld various service offerings into one organization. "Sam came to almost none of the meetings," says Neil Isford, a former IBM exec. "He always found an excuse to make a client call."

MAN OF THE PEOPLE

While Gerstner tends to be aloof, Palmisano is approachable. When IBM shipped its mainframe storage device two weeks early in the fourth quarter, he visited the Poughkeepsie (N.Y.) plant, spending hours walking the shop floor, buying employees coffee, and shaking their hands. "You guys saved the quarter," he told the workers. "You're the heroes."

2000. "Sam has demonstrated that he's able to manage a whole spectrum of technology companies," says G. Richard Thoman, a former Xerox CEO who has worked with Palmisano at IBM.

The new IBM CEO is a hands-on guy who eschews the trappings of rock-star CEOs. He doesn't believe in big staffs or executive perks. He has never had an executive assistant and he answers his own e-mail. Until he became president, Palmisano insisted on driving his own car to work from his

home in Southport, Conn., refusing a comfy ride in one of the Lincoln Town Cars

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made available to Gerstner and other IBM brass.

Palmisano also channels his temper differently than his boss. While Gerstner telegraphs disgust by ignoring or shutting people out, Palmisano speaks his mind—sometimes at high volume, with table-pounding. But the storms pass as abruptly as they arrive. "He can get up in your face and then afterward, put an arm around you and forget about it," says Plural's Isford.

One thing to bet on: Palmisano will shake up the troops. When he took over daily operations, one of his first moves was to make the monthly sales forecast meetings weekly. This was no easy switchover. IBM had to build a new sales-management system for Palmisano's stepped-up schedule. Now, IBM collects sales data every day, and Palmisano gets weekly reports. One trick he uses to make managers squirm: He'll ask for a list of deals they plan to close in the next week. Forget monthly or 90-day sales forecasts. He wants a follow-up e-mail in seven days. "I watched guys just get shattered," says Etherington. "You can hide in a 90-day forecast. You can't hide in a weekly discussion."

Palmisano gets the tough work ethic from his father, who owned an auto-repair shop in Baltimore. Friends and classmates remember him as a popular, outgoing, and happy kid who excelled in the classroom and on the football field. Palmisano

was an "A" student and played a mean center. While football at Calvert Hall College High School, a private boys school, he got hit in the nose and was bleeding profusely. Instead of asking to leave the game, Palmisano stuffed his nose and kept playing, says Tom Bateman, the former football coach. In his senior year, he was named the scholar-athlete in the National Football League banquet.

Palmisano entered Johns Hopkins University in 1968, the height of the antiwar movement. But he was no rabbiing lefty; he was there to get an education and play football. At graduation time, Palmisano wasn't sure what he wanted to do. He passed on an offer to try out for the Oakland Raiders. "I came to the conclusion that I wasn't going to make mark running into people who were twice my size," he says.

That left business. He joined IBM in August, 1970, as a marketing trainee associate in the data-products division in Baltimore. The division handled IBM's Big Iron mainframe and other servers. The first sign that Palmisano would become an IBM standout came in 1988. He was working on the launch of a new computer, the AS/400. At the time, Digital Equipment Corp. was clobbering IBM. Digital had a solid following among software developers who wrote programs for IBM machines. Until the AS/400, IBM would unveil a new machine, throwing it over the wall and praying for the armchair developers. Palmisano and the AS/400 team decided to give the time for a change. He went into high gear, meeting with software companies until he signed up 1,000 developers to create applications for the computer before it was rolled out. "It was one of the most successful product announcements that IBM ever had," says William O. Grabe, then vice president for marketing at the data-products group. Palmisano's boss.

That success put Palmisano on the radar screen. In the spring of 1989, then-CEO John F. Akers asked Palmisano to become his executive assistant. Palmisano was now an office employee with high potential—a "hi-po" in IBM lingo.

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everywhere
you look

Akers: "He handled [the job] better than anyone else had done it for me."

In 1992, Palmisano got the call that changed everything. Dennie Welsh, a senior exec who was pushing IBM into services, asked him to become president of Integrated Systems Solutions Corp. (ISSC), the group that became the core of Global Services. Welsh is credit-

Cover Story

ed with creating IBM's services business. But it was Palmisano who figured out how to make the business grow—profitably. "He sat us down and said we had to change the way we paid people," recalls George Samenuk, CEO of Network Associates

Inc., who sold IBM's outsourcing services to the bank industry. At the time, IBM paid sales commissions based on deal's size. Palmisano decided to base pay on how profitable the deal was. From 1993-96, when Palmisano was president of ISSC, revenues grew from \$14.9 billion to \$22.9 billion.

The services stint catapulted Palmisano to IBM's upper echelons. Until now, Palmisano has had every key job at the chief strategist. That won't come until Mar. 1. Thanks to Gerstner's powerful vision of selling technology solutions to customers, Palmisano can afford to gaze into his crystal ball with time being. Soon, he'll have to make some hard choices about his own game plan. He'd better start planning.

By Spencer E. Ante and Ira Sager in Armonk, N.Y.

PALMISANO: FROM BACKUP BAND TO FRONT MAN

Samuel J. Palmisano was named CEO of IBM on Jan. 29, replacing Louis V. Gerstner Jr. Although Palmisano has been at IBM for 28 years, he's not well-known in the computer industry. He revealed bits of his personal life and the challenges he faces at IBM in an interview with BusinessWeek editors Spencer E. Ante and Ira Sager.

What was your childhood like?

I was from a typical middle-class family. I had a wonderful set of parents and siblings. And you were expected to work hard and do well in school and behave. There was a little more discipline in the household than perhaps there is in mine.

Is it true you played the saxophone with the Temptations' backup band?

That is a true statement. In those days it was referred to as a studio musician. So when the Temptations would come to town, they hired union musicians to stand there and play. For a high school kid, I made \$1,000 in five days. I went out and I bought a car.

Was it your dream to become the CEO of IBM?

No, I mean, c'mon. Like anybody, you come to this place, you work your butt off, and you try to do your best. I didn't have a clue. Probably my first inclination was 18 months ago when I was named president. I was as shocked as anyone when I got called into Lou's office one day and he said, "I'm going to name you president." Believe me, it was a startling moment.

Lou has done a remarkable job turning around the company. How do you follow that act?

Lou has been able to establish a strategy for the corporation that's really working well. The customers' desire for productivity and strategic gain through e-business is driving them to solutions. We'll stay focused and keep executing and see if we can

in the computing model. We have protected those investments. We think those are going to be big plays. Whether every one is a home run or you just don't know.

How do you get growth going again?

We're going to assume that the industry doesn't have a huge rebound in 2002. If we keep taking share when there's an uptick in spending, it's a pretty safe assumption we're going to continue to do well.

You've made past decisions to get out of commodity businesses like memory chips. Will you consider that for hard disk drives?

Our problem has been execution. We're No. 1 in mobile and No. 2 in server share. So we're in the spaces we want to be in. The low-end consumer desktop space. We do have an issue that we haven't been able to execute so

of the new technologies of a year ago. We have a new team that's making progress. But you know, there's more work to be done.

Gerstner drove a cultural revolution through IBM to make it less bureaucratic. Yet critics say IBM still moves too slowly. Are you planning any changes to cut the red tape more?

None of us—Lou, myself, or anybody in IBM—enjoys bureaucracy. When we see things that don't help us run a disciplined business, we'll address it. The culture change in a large institution, when you're trying to drive a winning scenario, never stops. Whenever we see things that aren't helping, whether in sales or development, we'll address them.



LOU'S LESSON: Focus intensely on users and the market

gain as much share in 2002 as we did in 2001.

What did Lou teach you?

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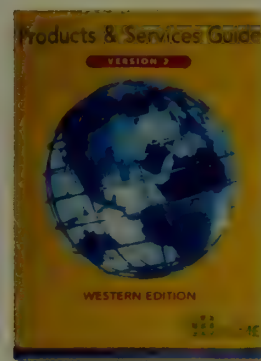
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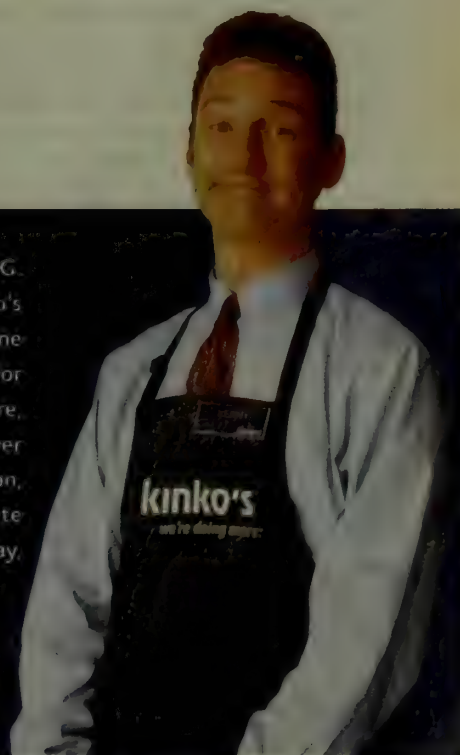
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WHAT'S THE TRUTH ABOUT WALTER HEWLETT?

Hewlett-Packard sees an "academic." Supporters see a smart shareholder advocate

Last Labor Day weekend, Walter B. Hewlett almost resigned from the board of Hewlett-Packard Co. The eldest son of HP co-founder William R. Hewlett was at a vacation home in the Sierra Nevada mountains, wrestling with how to cast his vote the following Monday on HP's proposed purchase of Compaq Computer Corp.

He hated the deal. But he had been told it would be completed with or without his vote, and he worried that a protest vote would allow Compaq to demand a higher price from HP. "I agonized all weekend," Hewlett says. "I could vote yes, vote no, or I could resign—and resigning meant I wouldn't have to vote against my convictions. But I've been involved with this company in some way for 50 years, and I felt it was important for me to stay involved. The employees couldn't resign from their jobs so I wasn't going to abandon my duties."

In the end, Hewlett made the decision to vote with the board, setting the stage for high tech's very own Peyton Place. Two months after the September vote, with HP's market cap cut by \$12 billion and the Hewlett family's stock down \$600 million, Hewlett declared his opposition to the \$24 billion purchase of Compaq. He said he would vote the 5% stake owned by the family and the Hewlett Foundation against the merger because foundation officials and his own financial advisers felt it would hurt the

company by giving it too much exposure to the lousy PC business. Since then, the dispute between Hewlett and the company's first outside CEO, Carleton S. "Carly" Fiorina, has escalated into a public battle for the soul of one of Silicon Valley's legendary companies.

When the dust settles, only one will probably be left standing. If Hewlett wins, Fiorina has hinted that she will leave HP. If Hewlett loses, there's little chance he will be renominated to the board of the combined companies, even though the foundation he chairs would still be one of the largest shareholders. Fiorina declines to comment, but Michael D. Capellas, Compaq's CEO, says he doesn't want Hewlett to remain a director if the merger goes through. "This thing has gotten a little ugly," Capellas says. "The battle lines are drawn."

And it's getting uglier by the day. Hewlett has accused HP's management of railroading him into voting for the deal by making unanimous board support part of the terms. He says an HP lawyer gave him the impression that a no vote could cost the company money. HP shot back with a "Dear Walter" letter, filed with the Securities & Exchange Commission, accusing him of fabricating the story. And in a January letter to shareholders, the company portrayed Hewlett as a "musician and academic," suggesting he lacked credentials to question a board with 300 years of combined management experience.

So what's the truth about Hewlett? He's a man of many interests and many contradictions, making him neither sinner nor saint in this boardroom. Friends say he has a sharp mind for business and is waging his fight on grounds of shareholder value rather than emotion. And some investors are pressed. "This clearly isn't someone who is acting because [the deal] isn't what his daddy would have done it," says John C. of America Capital Management. Kevin A. Fujimoto. While Hewlett is soft-spoken and private, he's not backing off this fight. "This is a game I've ran marathons. He has the body and mind for this kind of thing," says his brother-in-law, Jean-Paul Georges. "When he's convinced of something, he's not going to be shut up."

Hewlett's passion for HP goes back to his childhood. The second of five children, he was close to his father, who took him to HP regularly. But Walter chose to go deeply into academics instead of engineering at HP. "I had other interests. I wanted to develop an independent career," he says. After graduating from Harvard in 1966, he spent 12 years at Stanford, collecting a doctorate in physics and two master's degrees, in operations research and engineering.

Sound like a renaissance man? The 57-year-old plays 10 instruments, his favorite being the cello, and performs with several amateur ensembles.

A Corporate Soap Opera

Hewlett-Packard's reputation for dignity is being eroded as the fight between Walter Hewlett and HP management intensifies.



NOVEMBER, 2000 Hewlett buys 200,000 shares of HP after CEO Carly Fiorina raises growth targets. But HP begins to falter as the economy slows. That begins the erosion of

Hewlett's faith in top management, his colleagues say.

JULY 19, 2001 Hewlett misses the first day of a two-day board meeting where the Compaq deal is discussed in detail. The next day, when all the other directors agree drastic action is needed,

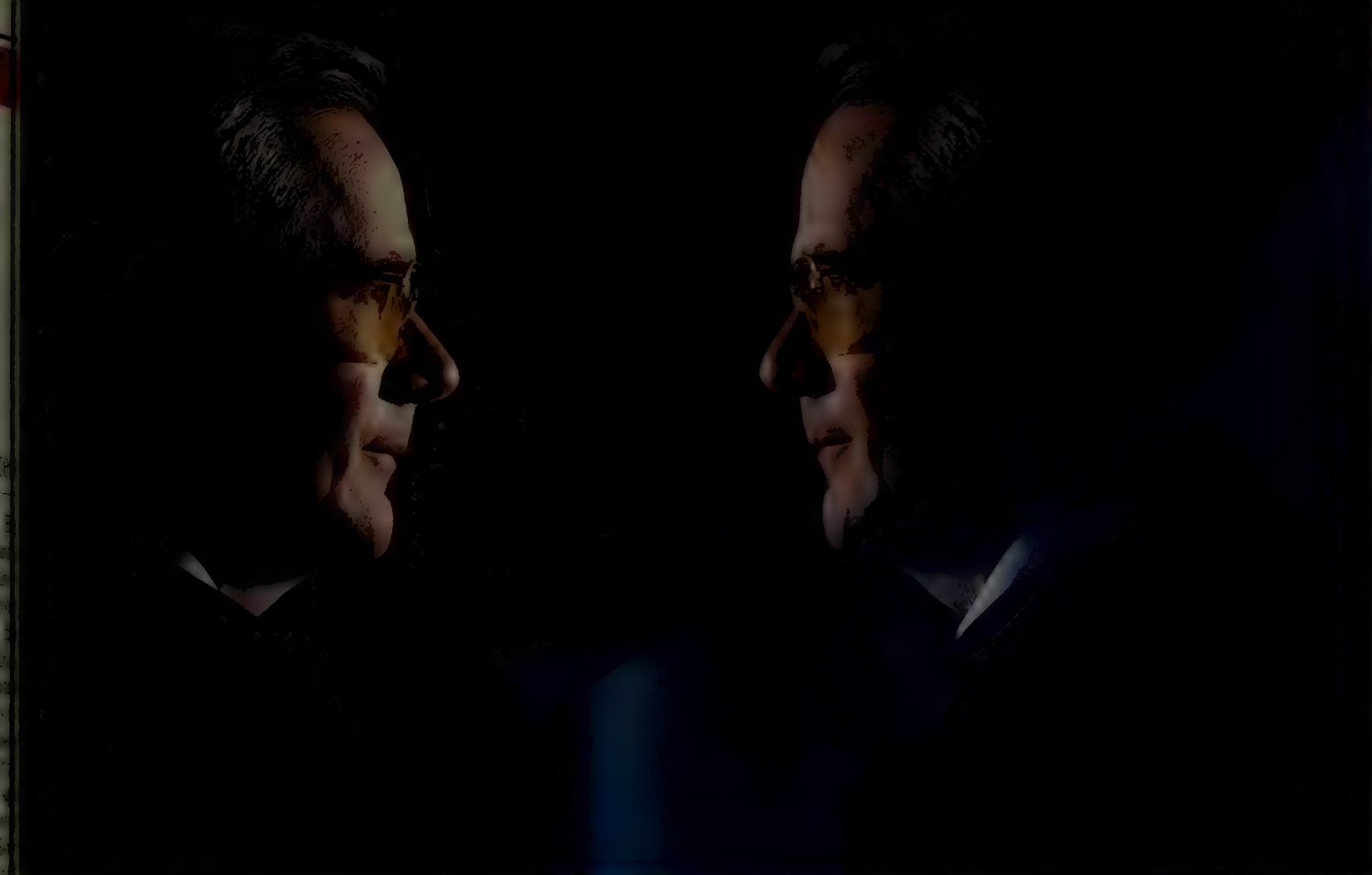
Hewlett says: "I don't know why you guys want to make a crisis out of this," according to a person at the meeting.

AUG. 31, 2001 Hewlett sees that the merger agreement claims unanimous board support and protests. An HP lawyer tells him the deal will be done even if he votes against it. Hewlett concludes the terms may have to be renegotiated, possibly costing HP money.

HP denies it suggested

SEPT. 1-2, 2001 Hewlett resigns before a board vote is taken but declines to leave. On Sept. 3, he votes against the deal but says he thought that he planned to support the government filings. Hewlett said no such

NOV. 6, 2001 Hewlett continues with his opposition



DES: Hewlett may be a "quiet man," but he also turns out to be a formidable foe

ensembles, among them a quintet that included Condoleezza Rice on piano. Hewlett left for Washington to become a National Security Adviser. He carries a book with him regularly. And singing is in his genes. He frequently codes all night at the Center for Computer Assisted Research in the Humanities (CCARH), a lab he created at Stanford University in 1984 to digitize classical music for easy access by students and others. Yet he avoids e-mail, preferring letters and the phone. Hewlett approaches the outdoors with the vigor he applies to his intellectual pursuits. In college, he was a class marathoner who finished the 1964 Boston Marathon with a time of 2:32. Even now, Hewlett trains

six months of the year for the Markleeville Death Ride, a 139-mile bicycle race over six Sierra Nevada peaks.

In some ways, Hewlett lives an inherited life in the long shadow of his father. He resides near the Palo Alto (Calif.) garage where HP was founded and still has the 1965 Volvo his father gave him for his 21st birthday. He and his four siblings have adopted their father's homespun ways. "People used to say my father was as common as an old shoe," he says with a smile. "He had a very good sense for what's important in life." While the family owns two mountain homes and shares a ranch south of Silicon Valley with the Packard clan, Walter shuns ostentation. He drives a Ford minivan and a \$17,000 electric car.

Although he has rarely sought the limelight, Hewlett is the public face of this publicity-shy family. His elder sister, Eleanor Hewlett-Gimon, is a homemak-

er and expert bridge player in Greenwich, Conn. Younger brother William Jr., who got his father's name since Walter was named after his paternal grandfather, is a psychiatry professor at Vanderbilt University. James Hewlett does volunteer work in Silicon Valley. And Mary Hewlett-Jaffe is an amateur botanist in Portland, Ore., where she is active in environmental matters.

Much of Walter's time is spent carrying on his parents' commitment to philanthropy and education. He chairs the William & Flora Hewlett Foundation, which last May gave a \$400 million gift to Stanford in his father's name, the largest given to a school at the time. He has purchased thousands of acres in the Sierras for preservation. And just as his father saved a beloved valley in Lake Tahoe from development, so has Walter. In the mid-1980s, he quietly put up \$660,000 to buy 560 acres that were

gives Fiorina 30% of the company.

Hewlett sends a letter to the board asking HP to pull out of the merger since 18% of the shares have been pledged against the deal.

DEC. 16, 2001 Because Fiorina and board member Richard Hackborn hint

they may quit if the Compaq deal is scrapped, Hewlett's attorney asks HP to disclose whether they or others plan to resign.

JAN. 7, 2002 In a letter to the SEC, HP accuses Hewlett of lying in his SEC filings when he claimed to have been railroaded into voting for the Compaq merger. Hewlett says HP's filing is filled with "half-truths."

JAN 17, 2002 HP runs print ads suggesting that HP founders "Bill and Dave" would have blessed the Compaq merger. Some HP insiders are irked. "There are a lot of people who are really offended by this," says Hewlett Foundation director Jim Gaither.

JAN 18, 2002 HP sends a letter to shareholders characterizing Hewlett as an "academic and a musician" and questioning his business acumen.



JAN 23, 2002 David Woodley Packard, son of co-founder Dave Packard, takes out an ad in

The Wall Street Journal criticizing Fiorina's attempt to invoke the HP legacy in her pro-Compaq ads. The final sentence: "There is now a real danger that HP will die of a broken heart."

slated to become part of a ski resort. The land is now part of Donner Memorial State Park. Asked once what his life's motivation is, he responded: "I'm really very simple. The privilege of my life is to be my father's son."

Although his critics argue that Hewlett opposes the Compaq deal because he wants to preserve HP as his father's company, his backers insist that's not true. They point out that until the Compaq deal, Hewlett had supported all of Fiorina's moves—including her aborted \$18 billion bid for the consulting arm of PricewaterhouseCoopers and HP's recent \$1 billion acquisition of high-end printer maker Indigo Technologies Inc. "There's no reaching back for the good old days," says former Verizon Communications President James Cullen, who sits with Hewlett on the board of HP spin-off Agilent Technologies Inc.

The big question is Hewlett's business experience. He's been on HP's board since 1987. And he is chairman of Vermont Telephone Co., a 21,000-line local phone outfit based in Springfield, Vt., that he started with a Stanford friend in 1994. But that's not enough, says Fiorina. "Walter Hewlett is a good man. But remember, it is he who is asking investors to accept his business judgment over that of HP's board and management team. We believe comparative business experience is germane."

Still, Hewlett is proving a formidable opponent. The Hewlett and Packard families have pledged their 18% combined stake in HP against the deal. Now, Hewlett has to win over only 40% of the remaining shareholders who vote. While Fiorina has won over some investors, so has Hewlett. Banc of America's Fujimoto was leaning towards voting with Fiorina, but a Jan. 24 meeting with Hewlett has him rethinking.

So how did the current mess come to be? His critics say Hewlett cavalierly refused to consider the merits of the deal. For starters, he missed part or all of three of the eight meetings to consider the deal. During a July 12 board meeting, Hewlett was in the mountains for the Death Ride. Hewlett says the meeting wasn't scheduled when he went on vacation and though he had left a phone number, HP couldn't reach him.

Then there was the two-day board meeting that started on July 19. The first day, everyone but Hewlett spent

more than six hours debating the acquisition. Hewlett was playing cello in a concert at Bohemian Grove, a high-powered, male-only retreat north of San Francisco. The next morning, with a chill in the air over Hewlett's absence, the board members were asked whether they believed HP needed to take drastic action, such as buying Compaq. As they went around the table, all of Hewlett's peers said yes. When it came to Hewlett, he said: "I don't know why you guys want to make a crisis out of [HP's situation]," according to one attendee. "Nobody said anything rude,

a board meeting following Hewlett's November surprise, Keyworth and born asked him to talk with them privately. They went to Bill Hewlett's office, which HP maintains as a shrine of sorts. There, they posed a question to Hewlett, says one critic: "What do you know what happens if you lose? What happens if you win?" The answer, the critic says, was that Fiorina and some board members might quit, leaving HP rudderless. "He turned ashen when it was clear he had not thought it through," says the critic. Hewlett says he has fully considered the impact of his

WALTER HEWLETT

BORN June 23, 1944 in Washington, D.C.

EDUCATION Lots of it. After getting his BA in physics from Harvard in 1966, he spent 12 years gathering three degrees from Stanford: an MA in engineering, an MA in operations research, and a doctorate in music.

FAMILY Hewlett is married, with three kids. He's the eldest son of HP co-founder William Hewlett's five children. Sister,

Eleanor is married to former HP board member Jean-Paul G. Gimon. Bill Jr. is a psychiatry profes-

sor at Vanderbilt. James does volunteer work in the Silicon Valley area. Mary Hewlett-Jaffe is an environmentalist in the Portland (Ore.) area.

THE FRUGAL BILLIONAIRE

Hewlett owns \$25 million in HP and Agilent stock and administers the \$4 billion Hewlett family trust. But like his father, Walter eschews the trappings of wealth. He shops at Costco and drives a cherry-red EV1, GM's electric car.

but there were lots of white eyeballs looking at the ceiling." Hewlett says he only questioned why the board was rushing into a big deal so quickly.

His relationship with the rest of the board only got worse after the Sept. 3 vote. His critics at HP say Hewlett repeatedly refused to talk in detail about his concerns when approached by board members Richard A. Hackborn and George A. "Jay" Keyworth in October. "The thing that hurts the most is [his] self-righteousness," says Keyworth. At

RENAISSANCE MAN He created the Center for Computer Assisted Research in the Humanities at Stanford in 1984 to digitize the scores of great composers. He loves computer programming so much that he often works through the night at lab. He also plays 10 instruments.

MARATHON MAN Finished 16th in the 1964 Boston Marathon with a time of 2:32, nearly fast enough to qualify for the Olympics. Still runs in the annual Markleeville Death Ride, a 139-mile biking competition over high Sierra peaks.

FAVORITE CAUSES He chairs the William & Flora Hewlett Foundation, the 19th-largest private foundation in the U.S. In 1986, he put up \$660,000 to buy 560 acres in Crystal Stream Canyon in the Sierras to prevent residents block development of a resort. The land is now part of a state park.

BUSINESS EXPERIENCE He has served on HP's board since 1987. He also serves on Harvard's Board of Overseers and on the board of Agilent, an HP spin-off. He chairs Vermont Telephone, a \$100 million a-year local phone company.

He certainly didn't back off. In November, he was visiting shareholders to garner support. So is there anything left of the chivalrous old HP? A bit: During HP's Jan. 17 board meeting, Hewlett offered to recuse himself when board members wanted to vote on how to win their proxy war with Compaq. As HP and Hewlett take the gloves over the next few weeks, that's as gracious as things get.

By Peter B. in San Mateo



EARLY DAYS: On a fishing trip with his father

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She was hard to be around. Not that she was vicious or violent or anything like that. Instead, she was uncomfortably odd. She made strange faces and hand gestures, had a stilted walk, peculiar mannerisms and an unnerving way of talking too close to your face.

Her deliberately assembled daily costumes (always including her trademark mismatched socks) were over the top. Eight-year-old girls are entitled to wide latitude for fashion peculiarities, but the aggressive nature of Amy's personal dress separated her from the rest of the world. She managed to disturb people before she ever spoke a word, and adults and children alike did their best to avoid her.

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that includes group homes, school day treatment. The one common denominator is a stable, homelike environment.

The breakthrough

For Amy, our answer came when she recognized her behavior as talent struggling to come out. We enrolled her in a local drama program and covered the cost out of our Special Needs Fund. She channeled her "oddities" into acting. Almost miraculously, the light bulb came on over her head.

She changed her attitude about herself. She tried to fit in. She told her teachers she no longer needed to be different and she modified her dress and behavior. She was suddenly ready to do what she had

to move on from the program and re-enter the world.

She went back to public school. Last May, she graduated from Sunny Hills Children's Garden and is now happily reunited with her relatives after years of separation. Her public school teachers say that she gets along just fine. The socks? Pretty much history. Amy puts it, "I only wear socks that don't match when I feel I don't

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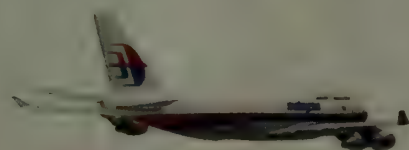
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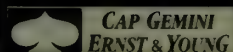


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COMMENTARY

By Louis Lavelle

SWING THAT AX WITH CARE

As the tech sector collapsed last year and rivals hunkered down for the long recessionary winter, Palm Inc. forged ahead. A new-product announcement whetted consumer appetites for the next big handheld, but a delayed launch slowed sales of existing Palms to a crawl. By March, demand had dried up so much that Palm had to cut 15% of its workers. Wall Street's response was vicious: Palm shares lost nearly half their value in one day and never recovered. Says Chief Financial Officer Judy Bruner: "There were a lot of questions about the viability of the business."

With the economy in the doldrums, the temptation to swing the layoff ax has never been stronger. But managers need a better plan than just reducing payroll or they risk seeing their stocks whacked. Companies with slash-and-burn approaches to cost-cutting will be punished by Wall Street because such layoffs are only stopgap measures that can't fix a fundamentally flawed business strategy.

During the 1990-91 recession, layoffs often were critical in helping U.S. business wring out inefficiency and boost productivity. Nevertheless, by undertaking deep, across-the-board payroll reductions, many companies were left temporarily ill-prepared to pull out of the slump when the downturn was over. According to recent Bain & Co. research, companies with the deepest layoffs underperformed the market by as much as 8% over the next three years. This time around, too many managers are making the same short-sighted mistake. They're opting for deep layoffs without making them part of a larger strategy to boost long-term performance.

Indeed, in an analysis of payroll reductions at companies in the Standard & Poor's 500-stock index for the



HOW TO WRITE A PINK SLIP

Wall Street punishes companies that cut jobs solely to reduce costs but rewards those whose layoffs are part of a strategic plan.

SEARS Cut 2,400 jobs in January, 2001, as part of a restructuring that included closing 89 stores. Shares rose 30% in six months.

PRAXAIR Cut 900 jobs in September, 2001, in response to the economic slowdown, while investing in new plants designed to pull it out of the slump. Shares rose 30% in three months.

PALM Trimmed 250 jobs in March, 2001, to cut costs after a delayed product launch slowed demand. Shares lost nearly half their value in one day.

PROVIDIAN FINANCIAL Reduced payroll by 550 jobs in November, 2001, to cut costs, but investors weren't convinced. Shares, down 90% in four months, never recovered.

12 months through last August, Bain found that layoffs that were part of a broader business plan generally got Wall Street's blessing. When they were part of a merger, shares rose 10%. When they were part of a restructuring, the stock spiked 13%. But companies whose layoffs were mainly for cost-cutting saw price declines of an average of 2%, from 30 days before the announcement to 90 days after. Why? "Layoffs may very

well be necessary, but they're never sufficient to solve long-term performance problems," says Bain director Darrell Rigby. Investors want some evidence that management is addressing those underlying problems.

It's a lesson Providian Financial Corp. learned the hard way. Providian, the nation's fifth-largest credit company, grew fat appealing to high-risk borrowers—the economy soured and loans surged, knocking its share price down more than 90%. Layoffs in November did nothing to lift the stock.

Contrast that with Sears Roebuck & Co., where CEO Alan J. Lacy announced restructuring in January, 2001, that cut 2,400 jobs, closed stores, and backed away from several smaller businesses. Wall Street bid shares up 30% over the next six months, even as earnings plunged. Says Kurt Barnard of *Barnard's Retail Trends Report*: "There was an insistence at least that major changes would be taking place at Sears of which layoffs were only a small part." Praxair Inc., a \$5 billion supplier of specialty gases and coatings, cut 900 jobs on Sept. 28, citing a slowdown in its key aviation market. It also announced initiatives to pull it out of the slump, including two new plants for products where demand was on the rise. The result: The value of its shares increased more than 30% in three months.

Managers should take note. Investors are quicker than ever to reward "good" layoffs and punish "bad" ones. If the business is struggling, Wall Street wants to see a coherent strategy for fixing the problem—just a wad of pink slips.

Lavelle covers management in New York.

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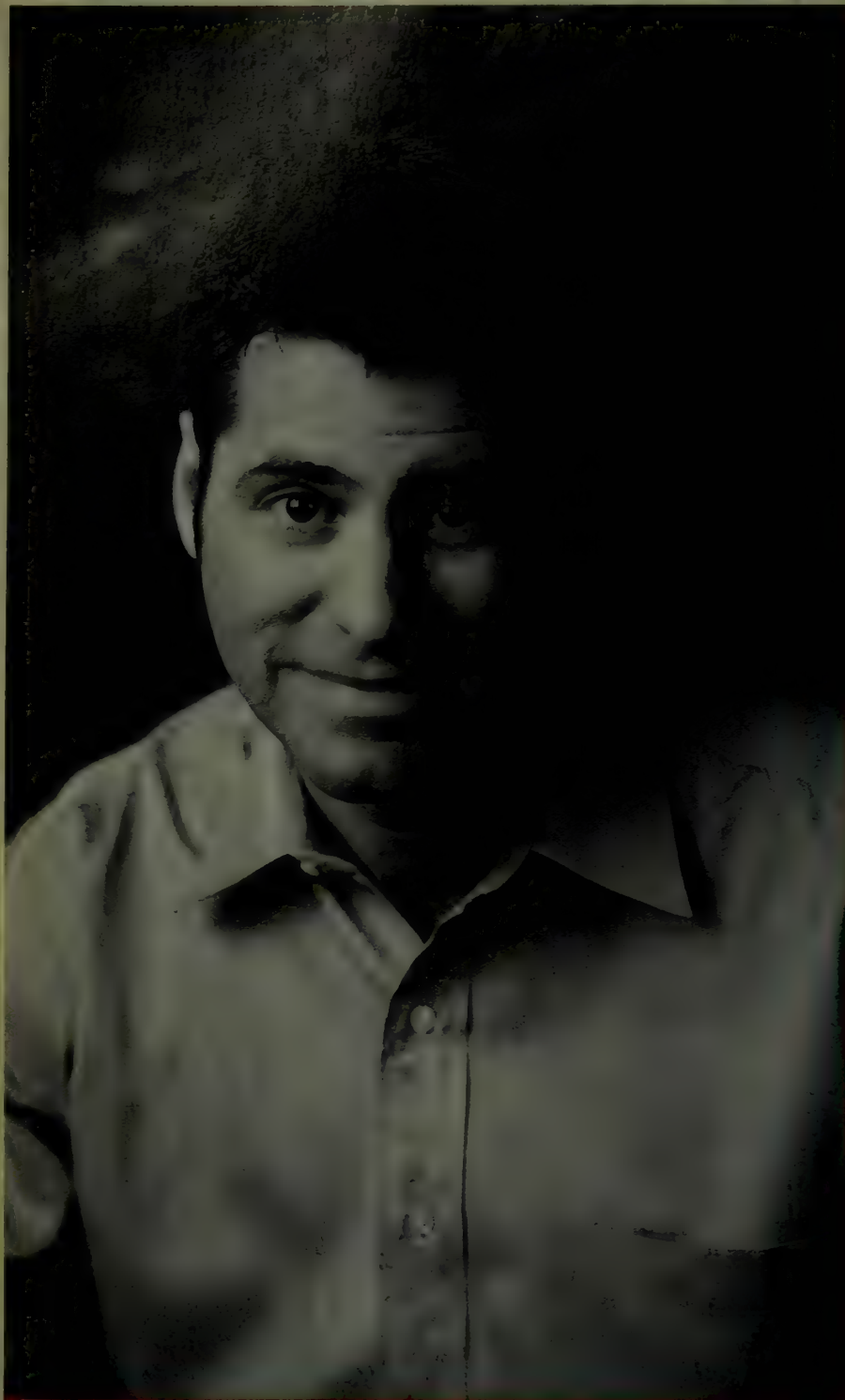
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ibay	...	16	1913 2.60 2.1
Orders	...	63	2549 23.98 22.90
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BostBeer	...	19	23 15 15.50 14.28 15
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BostProp	2.32	6.3	19 157 18 37.77 36.54 36.80
BostSci	...	...	85700 22.65 21.14 22.30
BoulderTR	20	1.2	q 632 16.35 16.00 16.27 +
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BoydGm	...	...	33 8334 8.15 7.20 7.65 -0.4
BoydC	...	...	11 1835 5.50 5.20 6.59 +0.5
BoydL	...	cc	1574 8.24 8.05 8.08 -0.0
BradyCp	.76	2.2	34 943 35.25 34.35 35.25 +0.45
Brandyw	1.76	8.5	30 3564 21.31 20.65 20.80 -0.02
Brascan g	1.00	...	1797 19.00 17.45 18.53 +0.83
BrasiTel	1.35	e 3.6	3155 39.10 36.78 37.71 -1.30
BrasiTel n	...	...	1355 15.50 16.05 16.40 -0.20
Brazil	.72	e 3.6	q 373 14.90 14.65 14.80 +0.05
BrazilEF	.18	e 4.2	q 94 4.30 4.20 4.25 -0.05
BrigStrat	1.28	1.30	47 11671 42.30 39.20 42.15 +3.05
BrilChina	.12	e 0.6	440 19.10 18.50 18.76 -0.06
Brinker	...	...	21 44891 30.40 31.75 31.88 -0.64
BrMySq	1.12	1.24	17 40684 49.70 45.33 46.25 -1.69
BritAir	...	cc	1978 33.65 29.65 31.49 -0.31
BritEngy	.51	e 3.5	524 14.89 14.49 14.68 +0.08
BritSky	...	...	41 63.89 61.30 61.80 -2.10
Broadwing	...	dd	62585 9.35 8.17 9.00 +0.89
BrilleP g	.40	2.3	13 3758 17.65 16.98 17.50 +0.53
BrwBrn	.19	0.6	37 37004 32.49 28.60 32.10 +2.05
BrwFA	1.40	1.21	19 74 57.40 55.95 56.28 -0.25
BrwFB	1.32	2.0	19 2042 56.29 54.00 55.25 -0.1
BrwSbe	.40	2.6	9 1643 15.61 15.15 15.80 +0.0
BrwSw	.50	2.1	16 16734 24.65 23.30 24.39 +
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Wireless Networking: Misery Awaits You

Expect hours of hassle to get your PCs talking

BY DAVID ROCKS

Different brands of gear don't always communicate smoothly. And the distance computers can be from each other is vastly less than manufacturers claim

At any given time, I may have almost as many computers in my house as I have rooms. The no-name desktop and Toshiba laptop are mine, and up to a half-dozen others are assorted Windows-based and Macintosh units I'm reviewing for my job. For me, creating a network that allows me to swap files and hook all the PCs to my high-speed cable modem makes a lot of sense. But running wires through my 75-year-old house would be impossible.

So I decided to try something potentially better: a wireless network. Such a setup offers the added bonus of letting you surf the Web not just from any computer but from any room in your house—or even the backyard. It's something lots of other people are discovering as well. Now that a standard known as Wi-Fi (or 802.11b) has opened wireless-networking technology to at-home users, tech research firm Cahner's In-Stat/MDR expects 4.5 million U.S. homes to use such systems by the end of this year—triple the number today.

After spending many hours over several weeks getting my network up and running, though, I can tell you the process is not for the faint-hearted. Not only did I have to make numerous calls to various tech-support hotlines, but I became far more conversant with networking technology than I had ever aspired to.

Some of the problems I encountered: Even with the Wi-Fi standard, different brands of gear don't always communicate smoothly. And when the pieces do work together, there's no consistent look and feel to the software that controls them. So configuring the system gets more complicated if you mix and match equipment. Finally, manufacturers exaggerate when they say you can connect computers as far as 300 feet from each

other. My Compaq laptop sits downstairs in the kitchen, just 30 feet—as the termite bore—from the network antenna upstairs in my office. But reception is iffy, and it disappears altogether when I move 20 feet farther from the kitchen to the dining room.

Still, when the network works, it's great. If you decide to press ahead, the first thing you'll need is high-speed Internet access. Otherwise, there's little reason to bother. Sure, it's nice when your computers can share a printer and exchange files. But getting online from any PC in your house is what makes setting up a network worth the hassle.

Next, you'll need a wireless adapter card for each machine. These cards, from manufacturers such as Linksys, U.S. Robotics, 2Wire, Apple Computer, and a host of others, function as the antenna and radio that let your computer communicate with the network. Internal units for a desktop—which you have to open up the case to install—cost about \$50. If you don't want to do surgery on your PC, you can buy a \$100 stand-alone card that connects to your USB port—the slot where you plug in most digital cameras. For a laptop, you can get a \$100 credit-card size unit that slides into the PC slot. Or, if you're in the market for a new laptop, spend an extra \$100 to \$150 more for wireless capability.

Personal Tech

Now comes decision time. What you're doing is sharing a network connection—and you don't care about swapping files—a simple wireless access point ought to suffice.

The access point plugs into your cable or DSL modem and lets the computers communicate with the modem. It works well and will set you back \$150 to \$200, although you'll have to use hard or floppy disks to move files from one computer to another. Linksys makes a \$150 unit that's easy to configure. With it I was able to get online from any PC in my house.

But I wanted more—and that's when my problems really started. The best way to share among your machines is with a router that lets computers on your network communicate with one another. You could add a stand-alone router to your access point, but many manufacturers sell access-point-and-router combinations which should be easier to set up and cost less than two individual devices.

Home Wireless Checklist

If you want to take the plunge and install a wireless network in your home, here's what you'll need

FAST INTERNET ACCESS Sure, it's nice to store or retrieve files from other computers. But to get online from anywhere in your house that makes setting up a network worthwhile. For most people, that means high-speed cable or DSL service, costing \$50 to \$60 per month plus \$100 or so for



says made the \$180 unit I finally on. But it took a good deal of scratching and time on the phone tech support to get it working right. I got my Internet connection among my computers—including an Apple iBook—was no trouble at all. Within a half-hour of opening the box, I was online. The problem was, I couldn't get the computers to communicate with each other. I called Linksys support, and after several minutes on hold, finally got through to a tech who told me—politely but firmly—that Linksys doesn't help customers configure wireless networks. As long as I was able to get my computer on the Internet, Linksys was of the opinion that the network was working. Anything else, and I was on my own.

He directed me to a Web site on networking, but there was no help. I finally called someone I knew at Linksys, who got another techie to call me. I spent nearly an hour going through all of the settings, with no luck. Then I happened to find out that I was running the Norton Internet Security 2002 firewall to protect against hackers.

"Oh, that's a real network killer," he told me. Bingo! As soon as I disabled Norton's firewall—which

was redundant since the router provides similar security—I was in business.

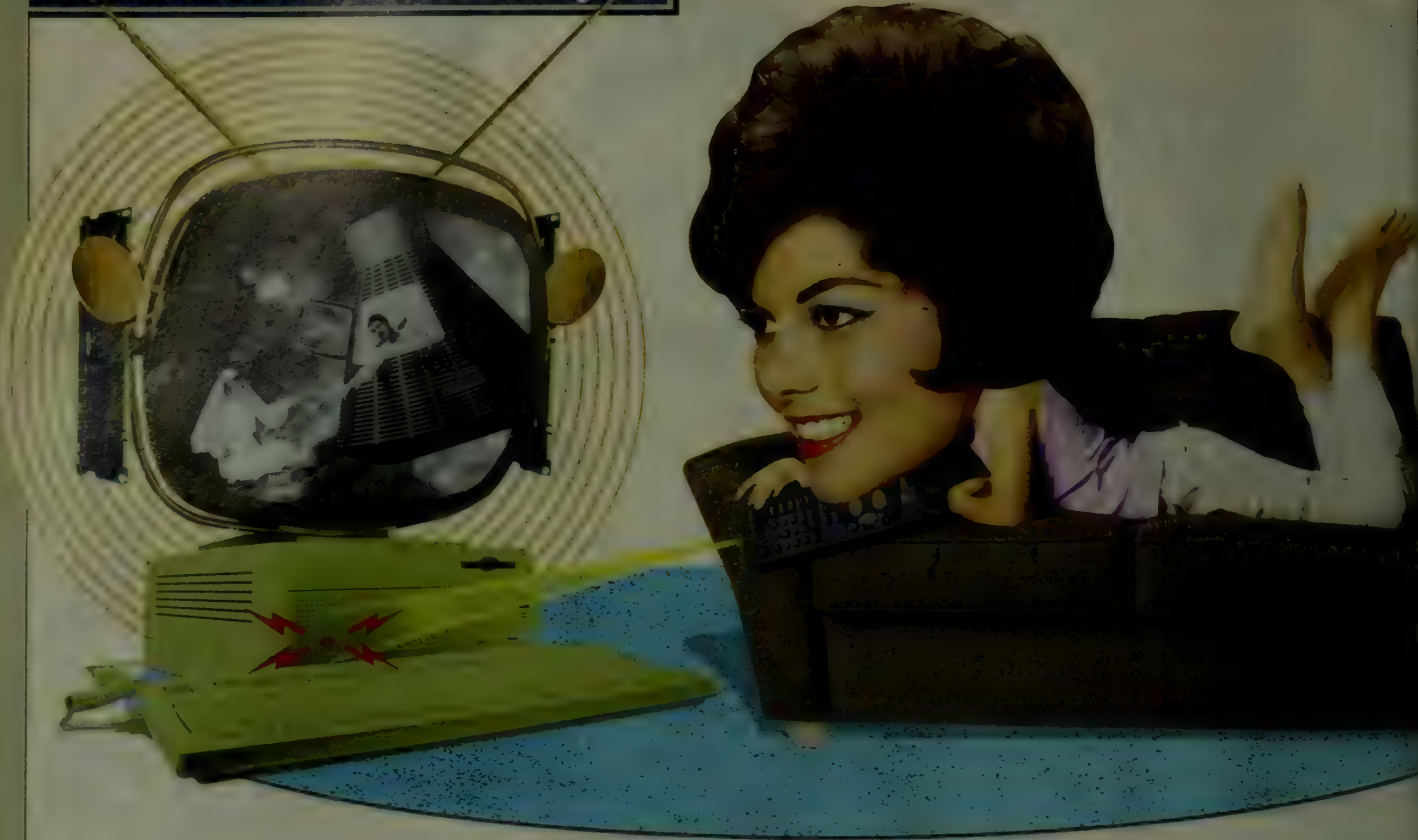
The lesson here is that myriad tiny issues can stymie your wireless-networking efforts. And that's going to keep many customers from getting WiFi despite its benefits. You may not run into the problem I had with the Norton program, but chances are something else will come up. Before I settled on Linksys, I had tried equipment from three other manufacturers—ActionTec, Apple, and U.S. Robotics—and ran into small problems that kept me poring over installation manuals for hours.

The good news is that things will get easier. My Toshiba laptop with Windows XP was far simpler to hook up to the network than machines running Windows 98 or 2000. Sure, I still had to fuss with the computer for 10 minutes or so. But in the complex world of wireless networking, that's no time at all. ■

CARDS You'll need one for each computer. Cards for desktops cost about \$100, while a built-in PC card costs about \$150 on a new machine.

ACCESS POINT If you only want to share an Internet connection—and don't need to swap files among computers—then a simple wireless access point is enough. They're easy to configure and run from about \$150 to \$200.

WIRELESS ROUTER This is a combo access point and router, which lets computers in your network communicate with one another. They cost around \$200. You can also buy a stand-alone router for less than \$100 and combine it with an access point.



Let Your PC Turbocharge Your TV

Personal video recorders such as TiVo cost a lot; why not build one yourself

BY
LARRY ARMSTRONG

It took me just half an hour to install the circuit board, load the software, and hook up all the cables to the computer monitor, speakers, and TV

For avowed couch potatoes, the biggest advance in video in recent years has been the personal video recorder (PVR). Set-top boxes from TiVo, ReplayTV, and Microsoft's UltimateTV bring such VCR-like features as pause and instant replay to live TV. They also let you search through electronic program guides for titles, actors, and directors—even keywords—to record hours of TV on their hard-disk drives. So when you finally hit the sofa at the end of a long day, it's not just for hit-or-miss channel surfing; there's always stuff on your PVR that you really want to watch.

But sales of PVRs, also called digital video recorders, have yet to take off beyond the million or so rabid fans, like me, who consider them today's must-have video appliance. For one thing, they're expensive compared with a \$99 DVD player or \$69 VCR. They start at about \$300 and go up to a cool two grand for models that can store hundreds of hours of TV shows. Many of them incur a \$10 monthly service fee on top of the purchase price—the last straw for many consumers.

To get around the hefty price tag and recurring fees, I set out to see if I could build my own—a do-it-yourself TiVo, as it were. After all, a PVR is nothing more than a special-purpose computer

with a big hard drive, and I already have a general-purpose computer with a big hard drive. Personalized TV listings, the presumed reason for the \$10 subscription fee, are widely available from such Internet sites as tvguide.com, zap2it.com. All I'd need to add is a little board to receive TV signals and some software to manipulate them.

My conclusion: It will cost you a little more than \$200, a free evening or weekend, and a little alert—the guts to open up your computer and tinker a bit to install the special circuit card. It's easier than you think. If you're still intimidated, I'll suggest a few ways to get around it.

Gizmos that you can install on your PC have been available for years. What made me take a second look, besides the new TiVo-like functions, was that these systems now come with all the connections necessary to separate out the television signal and send it across the room to a conventional TV. And they now come with remote controls so you can watch PC-TV on the big screen without longer tethered to a keyboard and mouse. You can change channels or turn up the volume. If the signal is scrambled, say, from a cable box, you'll have to use your cable box's remote to

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channels, but you will still get the PVR features.

I looked at two new systems, NVIDIA's \$200 Personal Cinema and ATI Technologies' \$400 All-in-Wonder Radeon 8500DV. The former doesn't sell under its own brand at retail, so I installed a version marketed by Compro Technology. A more widely available brand, VisionTek's Xtasy Everything, is identical, according to NVIDIA.

ATI now has a cheaper version than the one I tested, the \$200 All-in-Wonder Radeon 7500, announced on Jan. 22. It operates exactly like the top-of-the-line model, minus a few features. There's no digital connection for capturing video from digital camcorders, a drawback for those wanting to edit home movies on the computer. But I'm interested in using my PC as a PVR, and, between the ATI and NVIDIA systems, ATI came closest to duplicating the features of TiVo and ReplayTV.

Both are basically graphics cards designed to replace the one that came with your computer. There are others on the market that I didn't try out, such as the Marvel G450 eTV, about \$230 from Matrox Graphics. Hauppauge Computer Works takes a different approach: Its \$250 WinTV-PVR is a TV card that slips inside your computer and works with the graphics card that's already there.

Hauppauge has a \$200 version that

Other retailers, such as Best Buy, charge \$40 for the same service.

If you're at all handy, you can install it. With the two systems I tried, it took about an hour to swap in the new circuit board, install software, and hook up all the cables that connect the picture from your cable TV or antenna

send the audio and video to your computer monitor, speakers, and TV. I've never done something like this before. The only scary part is the amount of time it takes to get the new card to

place. Tip: A quarter-inch nut driver, available at Home Depot, works much better than a screwdriver for taking off the computer case screws, and the one screw that holds the circuit board in the PC.

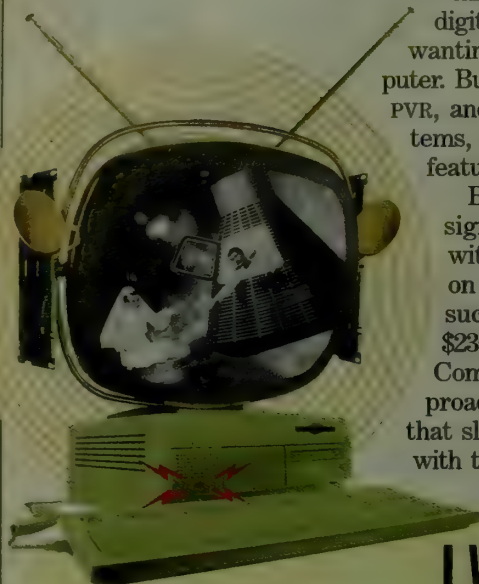
Besides the internal graphics card, both systems have a separate box the size of a cigarette pack connected to the back of the computer by a short cable. Mostly, it is jam-packed with different connectors you need to hook up your consumer-electronics gear, such as a TV for archiving shows you've recorded. (You can also burn the shows onto a CD if your computer has a writeable CD drive.) A key difference: NVIDIA's remote control uses infrared light, which means that its connector box must be in line of sight of the remote. ATI's radio-frequency remote works even when the box is hidden behind the computer or in another room.

Once you're up and running, you'll be amazed at how powerful a little computer can be. You can pause the picture in the middle of a trip to the kitchen, start up the show when you return, jump back 10 seconds for an instant replay, or if you're watching a show, jump ahead 30 seconds to skip a commercial. You can watch a show to watch later, start watching at the beginning before recording is

While the ATI system handles these TiVo features flawlessly, NVIDIA still has some rough spots. You lose the picture for about five seconds when you go from live TV to the PVR mode, for example. And while ATI's program guide is fully interactive and is searchable a week in advance, you have to connect to the Internet every time you want to see TV listings on NVIDIA's system and then use a grid to find programs you want to record.

Does this mean I'm ready to junk my old system (and its \$10 fee) and hook my PC up to my TV? Not quite yet. While ATI comes close, it's not quite as tightly integrated, elegant setup that TiVo is. PC-TV sure is a nifty way to outfit a system with all those PVR tricks that I've come to love. This time, though, they're virtually free.

Personal Tech



I Want My PC-TV

BRAND/MODEL	PRICE	COMMENTS
ATI TECHNOLOGIES (ati.com)		
ALL-IN-WONDER RADEON 8500DV	\$400	Best all-around performers, with all TV recorder features and more, such as zoom; its integrated program guide is fully searchable. High-end model has added features for gamers. For recording TV, lower-priced model is fine.
ALL-IN-WONDER RADEON 7500	200	
NVIDIA (nvidia.com)		
COMPRO GEFORCE2 MX400 PERSONAL CINEMA	200	Compro and VisionTek brands are identical. They're an O. K. second choice, but the remote control is rudimentary, and program listings are difficult to search, although a search-by-title feature is expected soon.
VISIONTEK XTASY EVERYTHING 5564 PERSONAL CINEMA	200	

plugs into the USB port that comes on all new PCs. You don't have to open up the computer to install it, and it's the only way to get TV and PVR features on a laptop.

You'll need a pretty powerful computer to take full advantage of these systems' ability to record, compress, and play video signals in real time. The kitmakers recommend at least a processor that runs at 800 or 900 Megahertz, and 80 gigabytes of hard-drive space to store all your TV programs.

If you're in the market for a new computer, it's simple: Tell the retailer you want the upgraded TV and PVR capability, and it will come already installed. Or, if you buy the kit from CompUSA, the store will install it in your computer for free.

The Harold W. McGraw, Jr. Prize in Education



Freeman A. Hrabowski, III



Mary Catherine Swanson



Carl A. Cohn

DR. FREEMAN A. HRABOWSKI, III As an educator, administrator, researcher, and civil rights advocate, Dr. Freeman A. Hrabowski, III has demonstrated an unwavering commitment to educational excellence and minority achievement, particularly in math and science. Dr. Hrabowski became president of the University of Maryland, Baltimore County (UMBC) in 1992 and has rigorously promoted excellence in undergraduate teaching, research, and graduate education.

Through Dr. Hrabowski's *Meyerhoff Scholars Program*, UMBC has become an elite school for aspiring African-American scientists, engineers, and mathematicians. As a result of the program, which each year awards scholarships to 50 high school graduates who have shown promise in math or science, UMBC is among the nation's leaders in the numbers of undergraduate degrees awarded to African-American students in the life sciences and computer and information science. Nearly all Meyerhoff students have gone on to graduate or medical school.

Honoring three educators whose lessons reach us all

Once a year, we honor educators whose innovations and efforts have raised the standards of the field of education and greatly improved the prospects of the students in their charge. This year's panel of judges selected a trio of honorees whose careers have been dedicated to eliminating education's achievement gap.

As part of The McGraw-Hill Companies' support for education, *The Harold W. McGraw, Jr. Prize in Education* was established in 1988 to mark the corporation's 100th anniversary and to honor its Chairman Emeritus for his lifelong commitment to education. The award salutes those who have had a meaningful impact on others.

Each of this year's honorees has found ways to improve education for students who have been traditionally overlooked. Through their unique programs, high expectations, incessant support and plain old hard work, their students have been exceeding people's expectations for years.

We are honored to salute them.

MARY CATHERINE SWANSON As founder of the secondary school program AVID (Advancement Via Individual Determination), Mary Catherine Swanson has touched the lives of thousands of students around the world, especially low-income and underserved students.

A former high school English teacher, Swanson created the AVID program in 1980 to help prepare underachieving students for four-year college entry. Through rigorous curriculum, study skills, tutoring support, study groups and role models, AVID classes provide underserved middle and high school students with the academic and motivational support to succeed. A program that began with 32 students in one high school is now implemented in over 1,200 schools in 21 states and 14 foreign countries. More than 92 percent of AVID students enroll in college, a figure nearly one-third higher than national averages.

DR. CARL A. COHN As America's longest serving urban superintendent, Dr. Carl A. Cohn has made the Long Beach Unified School District (LBUSD) a model for high academic standards and accountability. In Long Beach, with the most diverse population of any large city in America, Dr. Cohn has focused his efforts on transforming the district into a place where high expectations are set and students and teachers are given the resources to succeed.

Dr. Cohn's district-wide accomplishments in the Long Beach public schools include record attendance, the lowest rate of student suspensions in a decade, a decrease in both the student failure and dropout rates, an end to social promotion, an increase in the number of students taking college preparatory courses, higher student achievement and significantly safer schools. His efforts have inspired leaders across the country to pursue meaningful school reform.



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Are You Expecting Too Much?

Share prices for most stocks reflect anticipated growth in the double digits



BY LEWIS BRAHAM

Investors often accuse Wall Street of inflating earnings estimates to hype a stock. But guess what? Investors are guilty of those outrageous expectations, too. Just look at Vitesse Semiconductor, the telecom-chip maker. Analysts estimate a 33.1% annual growth rate for the company's earnings for the next five years. But if you run the stock through a compensation model that incorporates earnings, prices, volatility, and interest rates, Vitesse's current share price of \$12.47 assumes that earnings will grow at a hefty 56.1% a year over the next five-year period.

Nor is Vitesse the only company for which investors have set such a high hurdle. We ran the numbers for all of the companies in the Standard & Poor's 500-stock index with the same valuation model, and the results are eye-opening. Twenty-two companies have expected annual earnings growth rates in excess of 40% priced into their shares (table); 81 have expectations of 20% to 40%. In short, investors are anticipating that nearly half the 500 will experience annualized double-digit earnings growth over the next five years. Is that realistic? By the bull market standards of the 1990s, yes. By historical yardsticks, it's not. Earnings growth for large-capitalization companies has averaged only 4.75% a year from 1926 to 2000, according to Ibbotson Associates, a Boston-based investment-research firm.

The growth rate incorporated into a stock's price—known as the “implied growth rate”—is useful for evaluating a stock's prospects. We derived these growth rates from the dividend discount model (DDM) designed by Benjamin Graham and John Maynard Keynes. Investors typically use DDMs to estimate a stock's price should be given its estimated earnings growth rate, its volatility, and current interest rates. But we turned the model on its head. We started with the current price and then worked backward to figure out what the growth rate should be to justify this price. That's the implied growth rate.

Results from a DDM can sometimes be surprising because they're dependent on certain assumptions. The model compares the implied growth rate and historical volatility of a stock to the yield and volatility of long-term U.S. government bonds. Since financial theory holds that higher-risk investments need to be compensated for the risk of lower returns, stocks, technology and other volatile stocks generally wind up with higher implied growth rates than low-volatility stocks, such as utilities. For instance, shares of semiconductor maker Intel have an implied growth rate almost three times as high as the average U.S. stock, so its implied growth rate is high to reward investors for the risk. Yet if analysts' earnings estimates are too low or the stock suddenly becomes more volatile in the future, then the DDM model's calculations will be wrong.

Supposing the DDM's assumptions are correct, you can then ask, for example, whether the implied Micro Circuits can really grow at

growth rate of 60.7% when analysts are estimating 36.9%. If you think the answer is the stock is a buy; if not, stay away. Peter Wolfe, an equity strategist at J.P. Chase, is a nonbeliever. "Applied Micro is a struggling midsize company in a competitive industry," he says. "It's incredible that it will hit the growth rate built into its stock price."

assigns the highest implied growth rates to technology and telecommunications companies because they have several strikes against them: earnings are either depressed or nonexistent, their shares are extremely volatile. Most had a good run up off their bear market and their prices already reflect a lot of good that may or may not happen. Some of the overpriced ones include Palm, with an implied rate of 88.6%; AT&T Wireless at 58.1%; and Sierra at 51.0%.

DDM can also spot cheap stocks. They're companies with extremely low implied growth rates such as old-fashioned electric utility

including First Energy and DTE Energy, which pay high dividends and are not very volatile. The implied rate is so low because much of the value is going to increase in the form of dividends.

if stocks look cheap, investors can't buy them from a model-driven Cyclical companies like Ford Motor, U.S. Steel, General Motors, Dow Chemical all appear now as cheap, but need to ask plenty of questions. "A lot of them are cheap because they should be," says Peter McCaffrey, portfolio manager of PBHG Cap Value Fund. Ford Motor is a slow-growth stock with tough competition and labor issues. Dow Chemical has a asbestos liability problem.

we put the entire S&P 500 through the model and also took a look at the very largest companies to see how they fared. According to the model, General Electric has an implied rate of 14.8%. All Wall Street analysts say the company exceeded that number, should take that as a step further. In the last 12 months, GE delivered \$127 billion

in revenues and \$13 billion in profits. Analysts estimate GE's earnings will increase 15.5% a year for the next five years. But maintaining that growth rate will be an enormous feat. Other blue chips with high implied growth rates for the next seven years include giant retailer Wal-Mart Stores (20.3%) and insurer American International Group (15.6%).

As with any investment tool, professional investors don't all take the same view of the usefulness of a DDM or of calculating implied growth rates. Edmond Choi of Grantham, Mayo, van Otterloo, a Boston investment-management firm, says he doesn't think the DDM is good for projecting values of individual companies, but he does believe it works well for ranking stocks within a group or index to identify the relative values among them. So even if the tech stocks in our table don't have implied growth rates exceeding 40%, relative to other companies in the S&P 500, they still look expensive. That should be enough of a concern for investors to stay away.

We turned a model that estimates what a stock's price should be on its head, working backward to see what a company's growth would have to be to justify its stock price

Investors' vs. Analysts' Estimates

The implied growth rate is the annualized earnings growth rate a company needs over the next five years to justify its current stock price. The higher the implied rate, the riskier the stock.

Using a valuation model from Bloomberg Financial Markets, we calculated implied rates for S&P 500 stocks and identified the highest, the lowest, and those for the largest companies.

We've also included Wall Street analysts' earnings estimates for the companies.

THE HIGHEST RISK

STOCK/ SYMBOL	RECENT PRICE	IMPLIED GROWTH RATE	ANALYSTS' ESTIMATE OF EARNINGS GROWTH
PALM PALM	\$3.90	88.6%	25.2%
APPLIED MICRO CIRCUITS AMCC	10.89	60.7	36.9
TEXAS INSTRUMENTS TXN	27.45	59.3	20.4
AT&T WIRELESS AWE	11.64	58.1	28.4
VIACOM VIA.B	39.45	57.6	22.4
POWER-ONE PWER	10.78	57.4	21.6
VITESSE SEMICONDUCTOR VTSS	12.47	56.1	33.1
PMC-SIERRA PMCS	24.15	51.0	36.7
CIENA CIEN	13.42	50.8	27.0
BROADCOM BRCM	45.46	49.5	37.1
JDS UNIPHASE JDSU	7.16	48.2	25.6
NETWORK APPLIANCE NTA	19.20	43.2	30.3
TERADYNE TER	29.05	41.9	21.2
CORNING GLW	8.10	41.9	19.1
UNIVISION COMM. UNV	35.94	41.8	31.7

THE LOWEST RISK

STOCK/ SYMBOL	RECENT PRICE	IMPLIED GROWTH RATE	ANALYSTS' ESTIMATE OF EARNINGS GROWTH
U.S. AIRWAYS GROUP U	\$5.10	0.05%	7.4%
CMS ENERGY CMS	23.59	0.05	7.8
FIRSTENERGY FE	36.24	0.05	6.6
NISOURCE NI	21.09	0.05	7.2
DTE ENERGY DTE	41.15	0.05	7.1
PUBLIC SRV. ENTERPRISE PEG	42.42	0.05	6.1
ALLEGHENY TECHNOLOGIES ATI	15.91	0.05	8.9
CUMMINS CUM	36.78	0.05	8.3
TECO ENERGY TE	24.43	0.05	7.2
TXU TXU	47.94	0.05	8.5
AMERICAN ELEC. POWER AEP	41.55	0.05	6.3
FORD MOTOR F	14.61	0.05	5.6
ALLEGHENY ENERGY AYE	33.76	0.05	8.6
SEMPRA ENERGY SRE	24.76	0.05	8.4
KEYSPAN KSE	32.46	0.31	7.2

THE LARGEST COMPANIES

STOCK/ SYMBOL	RECENT PRICE	IMPLIED GROWTH RATE	ANALYSTS' ESTIMATE OF EARNINGS GROWTH
GENERAL ELECTRIC GE	\$38.26	14.8%	15.5%
MICROSOFT MSFT	63.80	21.6	15.9
WAL-MART STORES WMT	58.40	20.3	14.1
EXXON MOBIL XOM	39.16	8.5	7.1
PFIZER PFE	41.70	12.1	19.9

STOCK/ SYMBOL	RECENT PRICE	IMPLIED GROWTH RATE	ANALYSTS' ESTIMATE OF EARNINGS GROWTH
CITIGROUP C	\$49.62	11.8%	14.3%
INTEL INTC	33.68	24.9	17.6
AMERICAN INTL. GROUP AIG	78.01	15.6	14.4
IBM IBM	109.28	14.7	12.2
JOHNSON & JOHNSON JNJ	57.65	10.5	13.9

Prices, implied growth rates, and estimates as of Jan. 25, 2002

Data: Bloomberg Financial Markets, I/B/E/S International

The Good, the Bad, and the Worse

Dishing out investment advice isn't easy in today's climate

BY ROBERT BARKER

Two years after the Dow Jones industrial average rolled over, the nation's publishers are pushing loads of books on how to survive recession and bear markets. I can safely state that, year after year, most personal investing books aren't worth much, and packaging them around fears of financial insecurity hasn't changed that sad fact. Just the same, opportunities lurk in unlikely places. I found lots of good stuff amid the new books that are not decorated with plunging stock charts or feral bear claws.

Opportunities lurk in unlikely places. I found lots of good stuff in the new books not decorated with plunging stock charts or feral bear claws

My favorite title this season surprised me—since I didn't buy the bullish argument at the heart of James Glassman's (and co-author Kevin A. Hassett's) last book, *Dow 36,000*. Glassman's latest, **The Secret Code of the Superior Investor** (Crown Business, \$25), lays out a 47-step recipe for your portfolio. A fellow at the American Enterprise Institute, Glassman has absorbed the fundamental lessons of such great investors as Warren Buffett and Sir John Templeton, and he restates them here in easy-to-digest portions: Don't bother shorting stocks. Don't try to time the market. Keep an eye on your expenses. Avoid trading. He also applies the lessons to today's markets. Glassman likes the odds offered by Treasury inflation-indexed securities, he's bullish on drug stocks, and he makes a reasonable case why, if you could buy only one stock, it should be General Electric. Glassman succeeds in his ambition to be to intelligent investing what Julia Child has been to French cooking: one who

makes the difficult thing doable without losing its essence.

Another very good choice is **Magic The 33 Key Ratios That Every Investor Know** (Wiley, \$29.95) by Peter Temple, financial writer and former investment adviser. In just a few pages, each written and laid out with admirable clarity, Temple walks us through such financial measures as "net tangible value" and "free cash flow" are built, where in financial statements they may be found, and what they mean. Temple mixes in real-world examples, and he fluently translates the jargon that can differ from country to country. I wrote about this book years ago. (Alert: The publisher swears that small computational errors in some of the tables will be fixed in a fresh edition due by March.)

Investing Bible (Hungry Minds, \$16.95) by Lynn O'Shaughnessy and **CNBC Guide to Stocks & Markets** (Wiley, \$16.95) by Jeff W.



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two more fair bets. The first is thick (570 oversize pages), comprehensive, and easy to dip into for the basics on everything from annuities to zero-coupon bonds. The CNBC guide is not so encyclopedic, but it struck me as the better value. A trim volume, it gets to the point and boasts a good glossary.

The imperative to be a skeptical investor is a lesson most of us learn the hard way. That's why you might do a favor for any friends who still use a stockbroker by giving them **Brokerage Fraud: What Wall Street Doesn't Want You to Know** (Dearborn, \$24.95). The authors, Tracy Pride Stoneman, a lawyer specializing in securities-fraud cases, and Douglas Schulz, a former broker at Merrill Lynch who now acts as an expert witness in arbitrations, battle stockbrokers for a living. In fact, their brief—that the industry is so riddled with conflicts of interest and rules tilted in its favor that many clients can't help but be suckered—may be read as an elaborate advertisement for their services. Yet they make enough of a case to get even very trusting investors to (wisely) think thrice about any broker's advice.

The quintessential market skeptic—a man who reveled in bull and bear markets, notably the 1929 crash—was Jesse Livermore. Most current investors who know of Livermore met him through the thinly veiled character Larry Livingstone in the 1923 book *Reminiscences of a Stock Operator*, since reissued (Wiley, \$19.95). That still remains worthwhile, but now writer and trader Richard Smitten has produced **Jesse Livermore: World's Greatest Stock Trader** (Wiley, \$19.95). Where the earlier book tells its story in the first person, Smitten steps back as an omniscient narrator to add much new material. This ranges from Livermore's youth on a Massachusetts farm to his suicide in the cloakroom of Manhattan's Sherry Netherland Hotel. Some of the imagined dialogue is hokey, and it all initially struck me as akin to the "colorization" of a classic black-and-white movie. But Smitten has contributed more, extending Livermore's account and making his market smarts newly accessible.

Naturally, some books surprise by disappointing, including **The New Rules of Personal Investing**



(Times Books, \$25), by *New York Times* financiers. After Floyd Norrington's overture, his colleagues weigh in with generally enthusiastic discussions of stocks, funds, bonds, forfeitures, and so on. Most advice they give is unobjectionable but tedious, suffering from a product-by-product approach. An exception is Gretchen Genson's take on traps, and myths, with a keen attention to how inadequate the insurance industry's Securities I

Protection Corp. truly is.

Two of the field's most heavily named names—Ric Edelman and Suze Orman—do much for more experienced investors. **Financial Security in Troubled Times** (HarperB, \$14.95) is the latest from Edelman. He released this one on Sept. 28, with an eye to the fears after the terrorist attacks sent plunging. A weekend later, he was done, a few weeks the book hit stores—my local Barnes & Noble had it propped right behind the counter. This slim item is a Cliffs Notes to Edelman's earlier books. It provides much advice you probably don't need, such as how to endorse properly. Moreover, if you were curious about portfolio moves Edelman suggests after September 11, forget it—he makes none.

The Queen of Personal Finance, Suze Orman, is in no danger of being toppled as she extends herself from being just your checkbook's friend to a cross between Oprah Winfrey and Martha Stewart. Her **Money Cards That Lead to Wealth** (Hay House, \$15.95) is a collection of epigrams—"The courage to be rich has to do with vision"—on decorous 3.75-inch-square cards that could double as coasters. Less experienced investors who may be attracted to Edelman's book would do much better with the latest edition of Andrew Tobias' venerable **The Complete Investment Guide You'll Ever Need** (Harcourt, \$14.95), with new parts on college-saving plans, tax-indexed bonds, and estate plans.

Tobias has long counseled against trusting anyone but yourself with your money. I can't help but wonder how Enron's former CEO Kenneth Lay, could advise employees that their company was in good shape just weeks before its shares crashed, then I have one final recommendation. **The Rise of Mr. Ponzi** (Inkwell, \$14.95) is the infamous financial schemer Charles Ponzi's republished memoir, which he wrote in 1920 after his deportation to Italy. It offers a cautionary tale—he called his scam the Securities Exchange Company, or SEC. And it illuminates, showing the chief of a rapidly failing enterprise how he thinks. "We all crave easy money," Ponzi writes. "And plenty of it." Knowing that, and knowing how to guard against it, is perhaps the best advice you can get.

A Roundup of Titles

TO CONSIDER...

Brokerage Fraud: What Wall Street Doesn't Want You to Know
by Tracy Pride Stoneman and
Douglas J. Schulz

CNBC Guide to Money & Markets
by Jeff Wuorio

Investing Bible
by Lynn O'Shaughnessy

Jesse Livermore: World's Greatest Stock Trader
by Richard Smitten

Magic Numbers: The 33 Key Ratios That Every Investor Should Know
by Peter Temple

The Secret Code of the Superior Investor
by James K. Glassman

...AND AVOID

Financial Security in Troubled Times
by Ric Edelman

Money Cards: Words That Lead to Wealth
by Suze Orman

The New Rules of Personal Investing
by Financial Correspondents of
The New York Times

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Fidelity Dividend Growth Fund ³	★★★★★	★★★★★	★★★★★	N/A
Fidelity Equity-Income Fund	★★★★	★★★	★★★★	★★★★
Fidelity® Fund	★★★★	★★★	★★★★	★★★★
Fidelity Value Fund	★★★★	★★★★	★★★	★★★★
Bond Funds				
Fidelity Ginnie Mae Fund ⁴	★★★★	★★★★	★★★★	★★★★
Fidelity Intermediate Bond Fund	★★★★	★★★★★	★★★★	★★★★
Fidelity Investment Grade Bond Fund	★★★★	★★★★	★★★★	★★★★
Fidelity Short-Term Bond Fund	★★★★★	★★★★★	★★★★★	★★★★

Best performance is no guarantee of future results. Visit Fidelity.com or call Fidelity for current performance figures and Morningstar ratings. As of 11/30/01: Diversified International was rated against the number of funds in the Morningstar International Equity Fund category 1304, 862, and 163 for the 3-, 5-, and 10-year periods, respectively; the number of funds in the Domestic Equity Fund Category was 4699, 3005, and 887 for the 3-, 5-, and 10-year periods, respectively, and the number of funds in the Taxable Bond Fund Category was 822, 1347, and 440 for the 3-, 5-, and 10-year periods, respectively.



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Should You Open Up To Closed-End Funds?

A little risk could bring a nifty payoff

BY MARA
DER HOVANESIAN

During bear markets, gaping discounts between closed-end-fund share prices and the value of their stock holdings tend to narrow, cushioning investors against some of the falls. Last year was no exception: Funds specializing in U.S. shares gained an average 6.5% even though their underlying assets lost 1.6% in value, according to the Closed-End Fund Assn., based in Kansas City, Mo. That was a much better performance than the Standard & Poor's 500-stock index, which lost 13%.

Closed-ends act like stocks because a fixed number of shares trade on an exchange, such as the New York Stock Exchange. But their underlying portfolio of stocks or bonds make them look like mutual funds, with net asset values (NAVs) calculated from the market value of their holdings. When the share price is above its NAV, closed-end funds are said to sell for a premium. With discounts, the opposite is true. So if the fund's asset value per share is \$20 and it's trading on the market for \$18, the discount is 10%.

Why the discount? "Because they're inefficient; nobody knows about them," says analyst Kevin McNally of Salomon Smith Barney. Discounts and premiums are good guideposts to closed-end funds. Naturally, a consistent outperformer can trade at a premium. But for the most part, paying above a fund's NAV isn't a good idea, while heavily discounted funds often deserve their rock-bottom prices. For example,

the Equus II fund has traded at a 31% discount for five years because many investors are leery of its penchant for leveraged buyouts and startups.

The moral is to buy funds in an asset class that makes sense otherwise, discount or no, the investment bargain. If you are a bold contrarian and growth is set for a comeback, you might one of the handful of growth closed-ends such as the Bergstrom Capital fund, which a discount of 9%. But if you're still wary of value plays, there's less choice because few value funds still trade at a discount. One does: the small-cap Royce Value Trust managed by veteran value manager Royce. It has a 9.5% discount even though the fund's shares gained 15.8% last year and rose 20.6%.

Is there still serious money to be made in closed-ends? At first blush, the answer is yes. More than half of the 524 funds tracked last year still trade below their NAV, including bond funds. The trouble is, say pros, that the most potential for superior gains are specialists in the sectors investors love: emerging-market, foreign, and growth. "But if you know what you're doing, you can make unbelievable money," says McNally.

The best buys right now require taking some risk. Posting some of the largest losses last year was the international-markets category, down an average 3.9%, while NAV fell 9.9%. The Closed-End Fund Assn. Loss reports the Closed-End Fund Assn. Loss discounts narrowed sharply from 2000: shares and NAV lost 23.5% and 22.2%, respectively. Analysts say global and emerging-market funds could move toward premiums in good places to park some money. It happened before: When investors soured on emerging markets in 1998, closed-end foreign were trading at large discounts—some over 30%. But after the market rebounded the next year, those same funds sold at double-digit premiums as share prices jumped 54.9% and portfolios gained 58.2%. Share prices and NAV for only funds rose 63.7% and 69.5%, respectively.

Growth & Global: Laggards with Promise?

FUND CATEGORY	2001 RETURNS		5-YEAR ANNUALIZED RETURNS 1997-2001	
	MARKET PRICE	NET ASSET VALUE	MARKET PRICE	NET ASSET VALUE
CONVERTIBLE SECURITIES	2.11%	8.89%	6.59%	8.67%
EMERGING MARKETS	-6.85	0.39	-0.80	-0.93
GENERAL BOND	5.56	5.66	5.65	6.47
GENERAL MUNI (LEVERAGED)	4.79	11.82	5.69	6.56
GENERAL U.S. GOVERNMENT	6.89	10.95	6.56	8.23
GLOBAL FUNDS	-34.56	-38.80	-6.40	-10.82
GROWTH FUNDS	-16.76	-14.08	6.16	9.60
SECTOR EQUITY FUNDS	-10.72	8.48	9.65	10.57

Data: Lipper Inc.



formance can offer attractive yields, too. Although they rose 12% last year, they still have an average tax-free yield of 6.25%, a full percentage point more than 10-year taxable Treasuries. Even moderate Fed tightening this year will have a negligible impact on yields, says William Fitzgerald, a managing director at John Nuveen, who oversees \$32 billion in muni closed-end assets. "Investors have been hedging against risk in the equities markets by moving into money market funds," he says. "But municipal closed-end funds are much more effective."

"Investors have been hedging against risk in the equities markets by moving into money market funds," says one pro. "But municipal closed-end funds are much more effective"

The one sector that is severely overvalued is high-yield.

On average, high-yield funds trade at 18.4% premiums, though some are as high as 35.7%. These funds have rallied in anticipation of a rebound after two years in the tank. But even if high-yield bonds do recover this year, closed-end funds are unlikely to share in the spoils since they're already overvalued. Investing in diversified high-yield funds that buy abroad might be a better bet. Despite its 24.6% premium, Salomon Brothers High Income is a possibility.

It has a third of its assets in emerging-market debt—and it's consistent, having beaten most of its peers since its January, 1993, launch.

Another way to buy high-yield debt without paying a high premium and exposing yourself to volatile price swings is through multisector funds. They diversify into government and corporate debt and tend to avoid borrowing. MFS MultiMarket Income Trust, with a yield of 7.8% and a discount of 5.1%, or Putnam Premier Income Trust, which sells at a 4% discount and yields 8.7%, are options.

Making good returns in closed-end funds by betting on a narrowing of discounts depends on a rebound in their sector or in the economy. But unlike smart buys in the stock market, bargains in closed-end funds are clearly marked as early-bird specials.

closed-end bond funds are another way to enter the international market. In general, discounted closed-end bond funds have an extra yield because they pay higher yields than open-end bond funds. That's because the interest on the bonds is higher than the share's lower NAV, not the market yield on the underlying bond portfolio. For example, a fund with a 10% yield and a 1.12% discount, its effective yield jumps to 8.88%. For example, Morgan Stanley

Witter's Emerging Debt Fund, which invests in government and corporate debt, sells at a 8.6% discount, which boosts the fund's yield of 11.4% to 12.5%.

Funds that invest in U.S. debt are trickier to assess. The bond market has seen discounts and the potential for returns have fallen, so tread lightly. Paul J. Parnes, director of closed-end funds at Morgan Stanley, recommends focusing on funds that could do well as the economy recovers. He's bullish on mortgage funds, such as Blackrock Income Fund, which has a decent 5% yield and a 7.6% discount. The fund looks attractive because it yields 10.4% mainly because it invests in emerging- and global-market debt as well as U.S. government debt. Hedged municipal funds may borrow to juice per-

Stocks and Bonds at a Discount

Closed-end funds that trade below their asset value

FUND	DISCOUNT*
EQUUS II FUND	-38.5%
MEVC DRAPER FISHER FUND I	-37.3
JARDINE FLEMING CHINA FUND	-19.8
SCUDDER NEW ASIA FUND	-19.8
INDIA GROWTH FUND	-19.6
LATIN AMER. EQUITY FUND	-19.6
LATIN AMER. DISCOVERY FUND	-19.4
INDIA FUND	-18.2
MALAYSIA FUND	-18.2
SINGAPORE FUND	-18.2
M.S. ASIA-PACIFIC	-18.1
EMERGING MKTS. TELECOM. FUND	-17.6
NEW GERMANY FUND	-17.6
TEMPLETON DRAGON FUND	-17.1
JARDINE FLEMING INDIA FUND	-16.7
M.S. INDIA INV. FUND	-16.4
M.S. EMERGING MARKETS FUND	-16.3
THAI CAPITAL FUND	-16.2
BRAZIL FUND	-16.0
NEW IRELAND FUND	-15.6

*As of Jan. 25, 2002

Data: Lipper Inc.

TRYING TO WAKE UP A TIRED OLD TECH FUND



BY ROBERT BARKER

rb@businessweek.com

Under a new taskmaster, T. Rowe Price's Science & Tech Fund hopes to run with the big dogs again by lowering risk in favor of solid, steady gains

Few mutual funds have disappointed so many careful investors for so long as T. Rowe Price Science & Technology. Once the nation's largest tech fund, ending 1999 with assets of \$12.3 billion, it seemed to have just what a smart fund picker could want: a solid long-term record, low fees, and a big research crew led since 1991 by one of techdom's most experienced hands, Chip Morris. Yet it failed to perform. Each year since 1996, even when it earned double-digit returns, it still trailed tech fund peers. Its assets have since dwindled to \$5 billion.

Now, Morris is leaving TRP to join his predecessor, noted tech investor Roger McNamee, at Integral Capital Partners, which runs venture capital and hedge funds. What can the T. Rowe Price fund's 363,000 holders expect from new manager Michael Sola? More diversification, with a higher number of stocks in the portfolio and smaller concentrations in any given industry. Also, less sudden swapping of stocks. "I tend to be more of an incrementalist when I trade," Sola told me the other day. "We just have to be better at identifying the trend and then sticking to it."

Sola comes to the job after serving under Morris since 1995 (table). Already he has gotten a taste of running his own show managing the \$26 million T. Rowe Price Developing Technologies Fund since its August, 2000, inception. The fund focuses on smaller-cap stocks than Science & Technology. Last year, it lost 31% while rivals fell 39% on average, according to Morningstar.

That solo performance is too short to draw any meaningful conclusions. But to get a sense of changes to come, it may help to look at Science & Technology's performance, which Sola witnessed up close. The fund, Morningstar analyst Scott Cooley said, had a stellar long-term record until the wild tech-stock years of 1998 and '99. It posted handsome returns of 42% and 101% in those years, respectively. Yet the average rival fund returned even more, 56% and 143%, as Morris hewed to TRP's custom of keeping a sharp eye on risk. In Cooley's view, "Morris had been so burned in the past by not being exposed to more speculative stuff that he thought it was a buying opportunity" in 2000 when tech stocks first sold off. The fund dumped such steadier companies as Microsoft and plunged into a bunch of racier techs, including Ariba and DoubleClick.



MIKE SOLA

NEW JOB Manager, T. Rowe Price Science & Technology Fund

ASSETS TO INVEST \$5 billion

AGE 32

EDUCATION B.S., William & Mary; M.B.A., University of Chicago

SECTORS WHERE HE SEES LONG-TERM GROWTH Software, semiconductors

SEMICONDUCTOR STOCK HE DOESN'T OWN Intel

PLEDGES ALLEGIANCE TO Boston Red Sox

HIS VIEW "If the March quarter is strong, then we're safely out of the woods with the economy. But it doesn't mean we're out of the woods [this year] with tech."

Wrong. As the market's stocks grew worse, the fund's trailing its peer group, losing 10% in 2000 and 41% last year. Sola declined to comment, saying: "We did not do a good job at recognizing the bubble after looking at it. You get caught up in it. Active performance.... Here we've learned our lesson."

Sola doesn't expect a market recovery ahead—at least not in 2002. "The days of seeing a 30% return [in 2000] are over," he told me. While not bullish on both areas, Sola favors semiconductors and software. He faces weak demand this year but is bullish on both areas in the long term. In chips, he favors companies with a diversified customer base, such as Analog Devices, over big, familiar Intel. "It has long-term growth issues," Sola thinks, as the growth in PC shipments slows. Sola also sees growth in network-security software, such as VeriSign, winding up with a nice chunk of corporate computing budgets.

Morris spread his bets over 50 or so stocks. Sola says his portfolio will expand to perhaps 100 names. Morris told me a couple of years ago that the fund's aversion to outside risks was unlikely ever to lead the pack of tech funds. He aimed instead to keep it solidly ahead of the average rival. That job now is up to Sola.

BusinessWeek online

For more on Michael Sola, go to barker.online.biz or www.businessweek.com/investor/ and click on "Investor's Guide."

WEAPONS CAPTURE?



Gene Marcial

Supplier
Industrial
for a buy.
Mario Gabelli
Penton's
pill?
aims to put
ames and
its tracks

With the war on terrorism, most defense stocks have rocketed up. Even tiny United Industrial (UIC) has taken wing. The company, which makes the U.S. Army's *Pioneer* unmanned aerial vehicle and training and electronic test systems, is little-known on Wall Street. Soaring from 13 on Sept. 10 to 20 in early October, the stock drifted down to 15 by mid-December. But it has since headed up—to more than 18. This latest upturn, however, may be due to nonmilitary events: takeover talk.

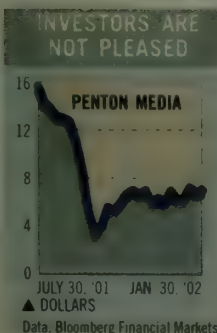
Steel Partners II, a New York investor group, which owns 10.5% of United, is pushing for a sale. Reliable sources say Steel has talked to an investment bank about finding a buyer. At yearend, an agreement expired that barred Steel Partners from trying to change management control at United. Steel Partners' CEO Warren Lichtenstein, who sits on United's board, had signed the pact on Mar. 7, 2001.



The scuttlebutt is that two major defense contractors are interested, and that a buyout price could be 22 to 28 a share. Charles LaLoggia, editor of *The SuperStock Investor* in Rochester, N. Y., says United would be "even more enticing if it sold its nondefense businesses, which are a drag on results." United produces equipment for steam heating and generating plants and also makes electric trolley buses. Selling these units would boost earnings and add to its working capital of \$5 a share, he says. The defense business accounts for 78% of sales. Value Line analyst Mario Ferro expects United to earn \$1.10 a share in 2002 on sales of \$310 million, up from an estimated 75¢ in 2001 on sales of \$295 million. United and Steel Partners didn't return calls.

ALL SET TO SHAKE UP PENTON MEDIA

Investor Mario Gabelli has reason to fume at Penton Media (PME), in which he has a 19% stake: The trade-mag publisher and trade-show operator has been losing money—and making no special effort to enhance shareholder value. And its stock plunged from 15.50 in July to 3.38 on Oct. 2, before rebounding along with the market; it's now at 6.75. Penton puts out 62 trade magazines, such as *Air Transport World* and *Internet World*; holds 185 trade shows a year; and operates 139 Web sites. All have been badly hurt by the recession and the collapse in ad revenues. In particu-



lar, Gabelli is irked at the poison pill management has put in place to thwart a takeover of the debt-ridden company. Gabelli says poison pills undermine the free-market system. In a filing with the Securities & Exchange Commission, Gabelli says that unless the board removes the pill, he will try to do so in a proxy statement at the next shareholder's meeting. Gabelli has sought the support of institutional investors, and some of his supporters say that he may push for the sale of Penton. Gabelli says Penton's assets are worth much more than the current stock price. Penton is worth 12 to 15 in a buyout, says Sven Monberg, special-situations analyst at Starr Securities.

Asa Graves of Wachovia Securities says a "return to more normalized operating levels in 2003 should result in a very attractive valuation at current prices." The analyst says Penton is a lot leaner because of efforts to cut costs and reduce debt. Although the first half of 2002 will be difficult, Penton expects a modest recovery in its businesses in the second half. Graves rates the stock a buy with a 12-month price target of 9, based on 11.9 times his 2002 earnings before interest, interest, taxes, and amortization of \$52.7 million. He expects Penton to lose 80¢ a share in 2001 and 61¢ in 2002. Penton declined comment.

HORSE RACING—AND MORE—AT MAGNA

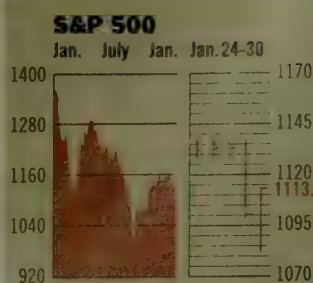
Can U.S. racetracks, where betting is in a downswing, reinvent themselves as entertainment centers? "That's the vision of Magna Entertainment," says Morton Cohen, who heads Cleveland hedge fund Clarion Management. Magna (MIEC), in which Clarion has been accumulating shares, owns and operates Thoroughbred racing at Santa Anita Park near Los Angeles—in addition to tracks in Florida, Michigan, Pennsylvania, and other states. Cohen says Magna, which is controlled by Magna International, plans to install a variety of gambling devices at the racetracks, including slot machines, video games, lottery systems, and screens for live video streaming of races. California recently granted Magna licenses to let Californians set up accounts at Magna for betting on horse races from home. Cohen says Magna's properties alone are worth more than its stock price, currently at 9 a share. His target is 20 for the next 12 months. He figures Magna will earn 25¢ a share on sales of \$500 million in 2002, and 35¢ on \$600 million in 2003.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:30 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

Investors responded positively to the Federal Reserve's decision to forgo a rate cut on Jan. 30, sending the Dow Jones industrial average soaring 145 points, or 1.5%. The jump, however, came on the heels of a 2.5% drop a day earlier, despite signs the economy is improving. For the week, Dow rose 0.3%, while the S&P 500 and Nasdaq slid 1.3% and 0.5%, respectively.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Jan. 30	Week	Year to date	Last 12 months
S&P 500	1113.6	-1.3	-3.0	-18.9
Dow Jones Industrials	9762.9	0.3	-2.6	-10.3
Nasdaq Composite	1913.4	-0.5	-1.9	-32.6
S&P MidCap 400	503.8	0.5	-0.9	-4.8
S&P SmallCap 600	230.7	0.9	-0.6	0.7
Wilshire 5000	10,425.4	-0.9	-2.6	-18.0

SECTORS

	Jan. 30	Week	Year to date	Last 12 months
BusinessWeek 50*	690.2	-2.8	-5.4	-34.6
BusinessWeek Info Tech 100**	398.9	-1.5	-4.9	-39.8
S&P/BARRA Growth	585.6	-0.6	-1.5	-17.9
S&P/BARRA Value	527.3	-2.0	-4.5	-20.6
S&P Energy	204.2	-0.4	-3.4	-11.1
S&P Financials	342.9	-3.4	-3.5	-14.3
S&P REIT	93.4	0.0	-0.1	5.6
S&P Transportation	207.5	2.4	5.3	1.8
S&P Utilities	134.9	-3.7	-7.5	-31.1
GSTI Internet	98.9	-1.9	-5.8	-57.7
PSE Technology	676.7	0.1	-1.6	-27.4

*Mar. 19, 1999=1000

**Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %		Last 12 months %
Trucking	10.8	Metal & Glass Containers	63.3
Food Wholesalers	10.1	Homebuilding	41.9
Gold Mining	10.0	Trading Cos. & Distribs.	41.4
Computer Stge. & Perphs.	9.9	Oil & Gas Refining	34.6
Office Electronics	9.8	Steel	31.2

GLOBAL MARKETS

	Jan. 30	Week
S&P Euro Plus (U.S. Dollar)	1006.8	-2.1
London (FT-SE 100)	5089.3	-1.1
Paris (CAC 40)	4407.3	-1.1
Frankfurt (DAX)	5052.2	-2.1
Tokyo (NIKKEI 225)	9919.5	-1.1
Hong Kong (Hang Seng)	10,757.0	0.0
Toronto (TSE 300)	7546.8	-0.1
Mexico City (IPC)	6750.8	-0.1

FUNDAMENTALS

	Jan. 29
S&P 500 Dividend Yield	1.42%
S&P 500 P/E Ratio (Trailing 12 mos.)	53.7
S&P 500 P/E Ratio (Next 12 mos.)*	21.0
First Call Earnings Surprise*	1.10%

*First Call Corp.

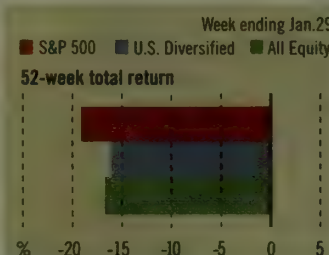
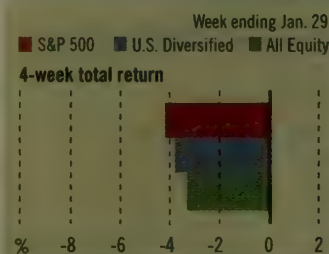
TECHNICAL INDICATORS

	Jan. 29
S&P 500 200-day average	1166.4
Stocks above 200-day average	55.0%
Options: Put/call ratio	0.64
Insiders: Vickers Sell/buy ratio	2.72

WORST-PERFORMING GROUPS

	Last month %		Last 12 months %
Wireless Services	-27.0	Multi-Utilities	-27.0
Multi-Utilities	-20.6	Computer S	-20.6
Conglomerates	-15.8	Telecomms.	-15.8
Gas Utilities	-14.8	Wireless S	-14.8
Entertainment	-14.2	Internet Sof	-14.2

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Precious Metals	10.0	Precious Metals	32.6
Pacific/Asia ex-Japan	4.1	Real Estate	8.7
Diversified Emerging Mkts.	3.7	Small-cap Value	8.5
Real Estate	-0.4	Mid-cap Value	1.0
Laggards		Laggards	
Communications	-8.7	Communications	-47.2
Health	-8.5	Technology	-44.3
Japan	-6.3	Japan	-33.5
Utilities	-5.9	Large-cap Growth	-27.7

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
American Heritage	87.5	CGM Focus	117.2
U.S. Glob. Inv. World Gold	15.3	Pilgrim Russia A	67.2
First Eagle SoGen Gold	14.7	Schroder Capital Ultra Inv.	65.0
Tocqueville Gold	14.1	Matthews Korea	61.2
Laggards		Laggards	
World GenomicsFund.com	-24.6	ProFunds UltraOTC Inv.	-77.1
Amerindo Hlth. & Biotech. D	-23.0	Merrill Lynch Focus 20 B	-73.6
Fidelity Select Wireless	-21.0	Berkshire Focus	-73.5
Montry. M. N. Wrld. Biotech.	-19.0	Berkshire Technology	-73.1

Interest Rates

KEY RATES

	Jan. 30	Week
MONEY MARKET FUNDS	1.66%	1.66%
90-DAY TREASURY BILLS	1.75	1.75
2-YEAR TREASURY NOTES	3.09	3.09
10-YEAR TREASURY NOTES	5.01	5.01
30-YEAR TREASURY BONDS	5.43	5.43
30-YEAR FIXED MORTGAGE†	5.96	5.96

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bd
GENERAL OBLIGATIONS	4.31
TAXABLE EQUIVALENT	6.25
INSURED REVENUE BONDS	4.44
TAXABLE EQUIVALENT	6.43

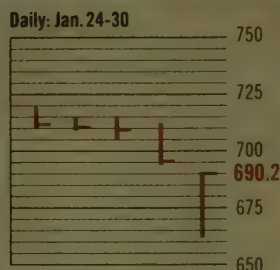
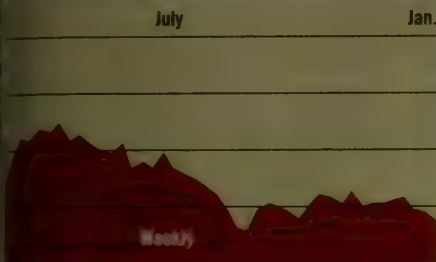
THE WEEK AHEAD

FACTORY INVENTORIES Tuesday, Feb. 5, 10 a.m. EST ► Manufacturing inventories probably fell 0.8% in December, after a 0.9% reduction in November. That's indicated by the drop in factory output.

PURCHASING MANAGERS' INDEX Tuesday, Feb. 5, 10 a.m. EST ► The Institute for Supply Management's index of nonmanufacturing activity likely rose to 55 in January, from 54.2 in December. The gain suggests that the service sector is turning around more quickly than manufacturing.

PRODUCTIVITY & COSTS Wednesday, Feb. 6, 8 a.m. EST ► Output per hour worked during the fourth quarter is projected to have risen at an annual rate of 1.3%, while unit labor costs are forecast to have grown by 2.5%. That's according to the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies. During the third quarter, productivity rose 1.5%, while unit labor costs increased 2.3%. Productivity is proving resilient during this recession.

INSTALLMENT CREDIT Thursday, Feb. 7, 5 p.m. EST ► Consumers likely added an additional \$9.5 billion of debt in December, after a record increase of \$14.7 billion during November. A four-point surge in vehicle sales prompted makers' 0% financing offers revolving debt up by \$14.4 billion in November on top of the \$14.7 billion borrowed in October. Revolving debt—consisting primarily of credit card debt—rose \$5.4 billion in November, the largest increase since April.



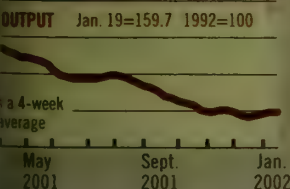
clung to the BW 50: Tyco International's revelation that it paid \$20 million to a director in its CIT Group acquisition and news that Merrill Lynch execs invested in a limited partnership from Enron's shareholders, sent shares of the companies tumbling 22.9% and 10.4%, respectively. Weak earnings stung AOL Time Warner, down 8.3%. For the week, the BW 50 fell 2.8%.

COMPANY PERFORMANCE

	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
General	-22.9	-36.4	26	Verizon Communications	-6.2	-4.9
Procter & Gamble	-1.6	-26.2	27	Citigroup	-4.0	-2.4
Johnson & Johnson	-14.9	-75.2	28	Sun Microsystems	-3.5	-45.8
Merck	-2.9	-49.1	29	Merck	1.0	-26.2
El Paso	4.7	-4.8	30	El Paso	-6.4	-50.0
Altera	-2.0	-92.0	31	Altera	9.7	0.4
Marsh & McLennan	-0.4	5.1	32	Marsh & McLennan	-3.8	-6.6
Household International	-0.6	-12.9	33	Household International	-7.5	-15.5
ChevronTexaco	-1.0	-19.6	34	ChevronTexaco	-5.3	-4.3
SBC Communications	-0.8	-22.2	35	SBC Communications	-0.1	-20.2
Mercury Interactive	-0.6	-7.0	36	Mercury Interactive	7.8	-34.5
AOL Time Warner	13.3	-61.5	37	AOL Time Warner	-8.3	-40.0
Washington Mutual	-8.6	-74.7	38	Washington Mutual	-0.6	2.1
General Dynamics	-0.8	23.1	39	General Dynamics	7.8	27.2
Comcast	-5.2	-19.5	40	Comcast	-0.1	-18.4
Morgan Stanley Dean Witter	2.4	-9.7	41	Morgan Stanley Dean Witter	-5.2	-17.3
Tellabs	9.5	7.1	42	Tellabs	-2.8	-65.5
Exxon Mobil	2.0	-18.0	43	Exxon Mobil	-0.5	-4.9
Scientific-Atlanta	-3.8	-17.2	44	Scientific-Atlanta	4.7	-44.3
U.S. Bancorp	3.7	-54.7	45	U.S. Bancorp	-2.7	-12.5
Paychex	-7.9	-14.2	46	Paychex	0.1	-9.0
Merrill Lynch	-0.6	9.3	47	Merrill Lynch	-10.4	-18.0
Bed Bath & Beyond	3.6	5.6	48	Bed Bath & Beyond	4.4	34.4
Texas Instruments	-2.0	-24.6	49	Texas Instruments	18.2	-5.2
Teradyne	-3.9	-1.7	50	Teradyne	5.1	-4.1

Production Index

Change from last week: 0.2%
Change from last year: -10.8%



index posted its fourth consecutive decline of the four-week moving average, ending 160.2, from 159.2. After seasonal but two components ended the week higher, as utilities posted the largest increase, as miners restore inventories. Also finished steel, lumber, crude-oil refining, auto traffic. Only coal and electric power showed the week lower.

For more information on the index components is at www.businessweek.com. Copyright 2002 by The McGraw-Hill Companies.

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THE RECESSION THAT WASN'T

Whoa! The ground under the American economy just shifted dramatically with the startling announcement that the country may never have fallen into recession in the first place. After looking at preliminary data, the Commerce Dept. said that gross domestic product for the fourth quarter of 2001 actually rose at a 0.2% rate instead of falling 1%, as widely expected. That means that only one quarter, the third, dropped into negative territory last year. It may not be much solace to the 1.7 million Americans who have lost their jobs since the slump started in March, but it usually takes two down quarters to make a recession. Unless these numbers are revised down—and they may be—the U.S. hasn't had a standard recession (page 32). Once again, this business cycle surprises. Washington policymakers and corporate executives should take note. The economic downturn, one of the mildest in recent history, seems over. Recovery is at hand. There appears to be no need for further fiscal and monetary stimulus.

What's behind the surprise? In a word: productivity. In previous downturns, productivity growth fell sharply. This time, however, it held up remarkably well as the economy plummeted from a 4% growth rate in 2000 to about 1% last year. A high rate of productivity growth fortified margins and allowed corporate managers to continue giving real wage raises to most employees even as they laid off large numbers of workers. In effect, we had a New Economy downturn characterized by strong productivity growth. Aggregate consumer spending never really dipped, as it has in the past, and people kept buying record numbers of cars and houses.

The economy's new flexibility also made a big difference this time around. The shift of most companies to contingent workers during the '90s allowed them to shed labor far more easily and quickly than ever before. And just-in-time inven-

tory systems allowed manufacturers to cut inventory record rates, setting the stage for a rebound.

The big question ahead is the strength of the economy. Conventional wisdom holds that it will be weak through the first half of the year. Unemployment is expected to rise to well over 6% as productivity growth permits companies to increase production while continuing to cut costs by letting employees go. And because consumers are still spending at a good clip, demand doesn't look like it will drop all that much over the next 12 months.

Another unknown is business spending. Capital spending on high-tech equipment to boost productivity has been a major force for growth for much of the past decade. It is expected to kick in to bring the economy back up to its potential growth rate of about 3% a year. Conventional wisdom holds that companies won't begin to spend on capital equipment until the first half of 2002. But it just may be that higher productivity and profits faster than expected, and CEOs start spending on high-tech capital equipment earlier. Corporate spending on high-tech capital equipment actually turned up in the fourth quarter for the first year. With surprise being the norm for this business cycle, recovery may be more robust than anticipated.

This is why the President and Congress should hold off from any further stimulus plans. Thanks to the administration's tax cuts of last summer, fiscal policy will provide a boost of nearly one percentage point to growth. Throw in higher post-September 11 spending for security and that could hit 1½%. It's time for restraint.

Bottom line: The worst is probably over, and the recovery wasn't as bad as it seemed. With any luck, the recovery is already started, and it will be better than expected. For now, still on the mend, this is good news.

BEWARE THE ANGRY INVESTOR

A post-Enron investor revolt appears to be brewing against companies seen as using loose accounting to pump up earnings. Tyco International, AOL Time Warner, Cendant, Anadarko Petroleum, Williams, PNC Financial Services, Dynegy, and even General Electric are getting pummeled in the stock market for what is viewed as flawed accounting. Investors are angry—but perhaps not angry enough (page 35).

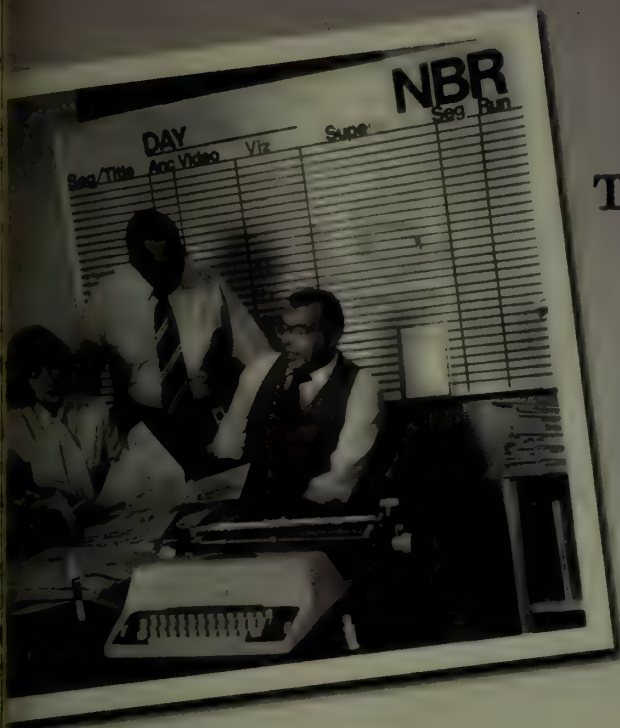
It is increasingly clear that Wall Street has known for years that many corporations had wildly exaggerated earnings, but it didn't tell the investing public. Some on the Street may be guilty of worse. Take the case of Enron Corp. and Merrill Lynch & Co. Merrill executives helped create the LJM2 Enron partnership and attracted institutional investors. As many as 100 of Merrill's own top executives put their personal money into the deal. Why? Because Enron's chief financial officer, Andrew S. Fastow, would run it, and he promised enormous

returns. That Fastow would also put \$2 million of his own money into LJM2 was seen as giving him even more incentive to generate big payouts. Fastow's glaring conflict of interest should have stopped the Merrill executives, actually an incentive to them: "A. Fastow's dual role creates advantage for the fund and Enron," said the Merrill Lynch prospectus to a select group of potential investors.

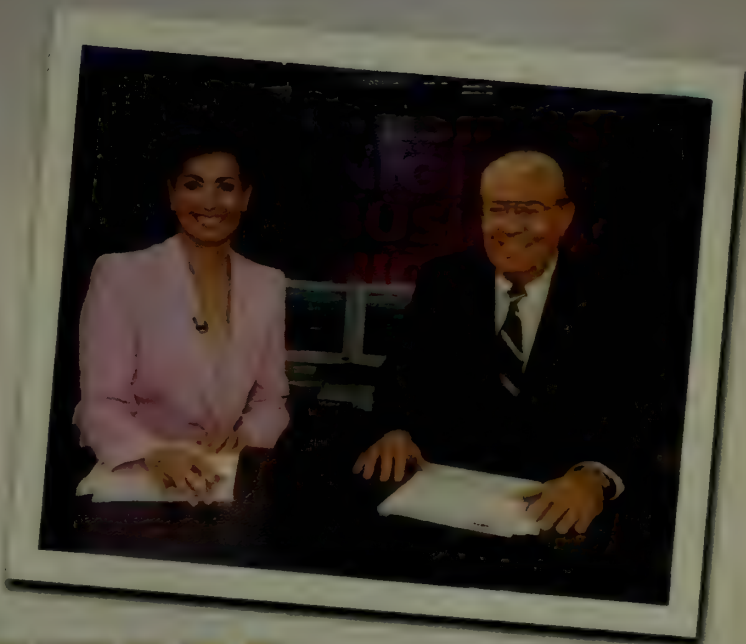
Many institutional investors declined to buy into LJM2 because of Fastow's conflict of interest. But some of the biggest institutions took a piece. Among them were Citicorp, Credit Suisse Group, Deutsche Bank, J.P. Morgan Chase, and Lehman Brothers.

What were they thinking? Much of the world's investment community turned out to be willing enablers of Enron. Wonder "Wall Street credibility" is fast becoming a thing of the past. Investors are angry, but are they angry enough?

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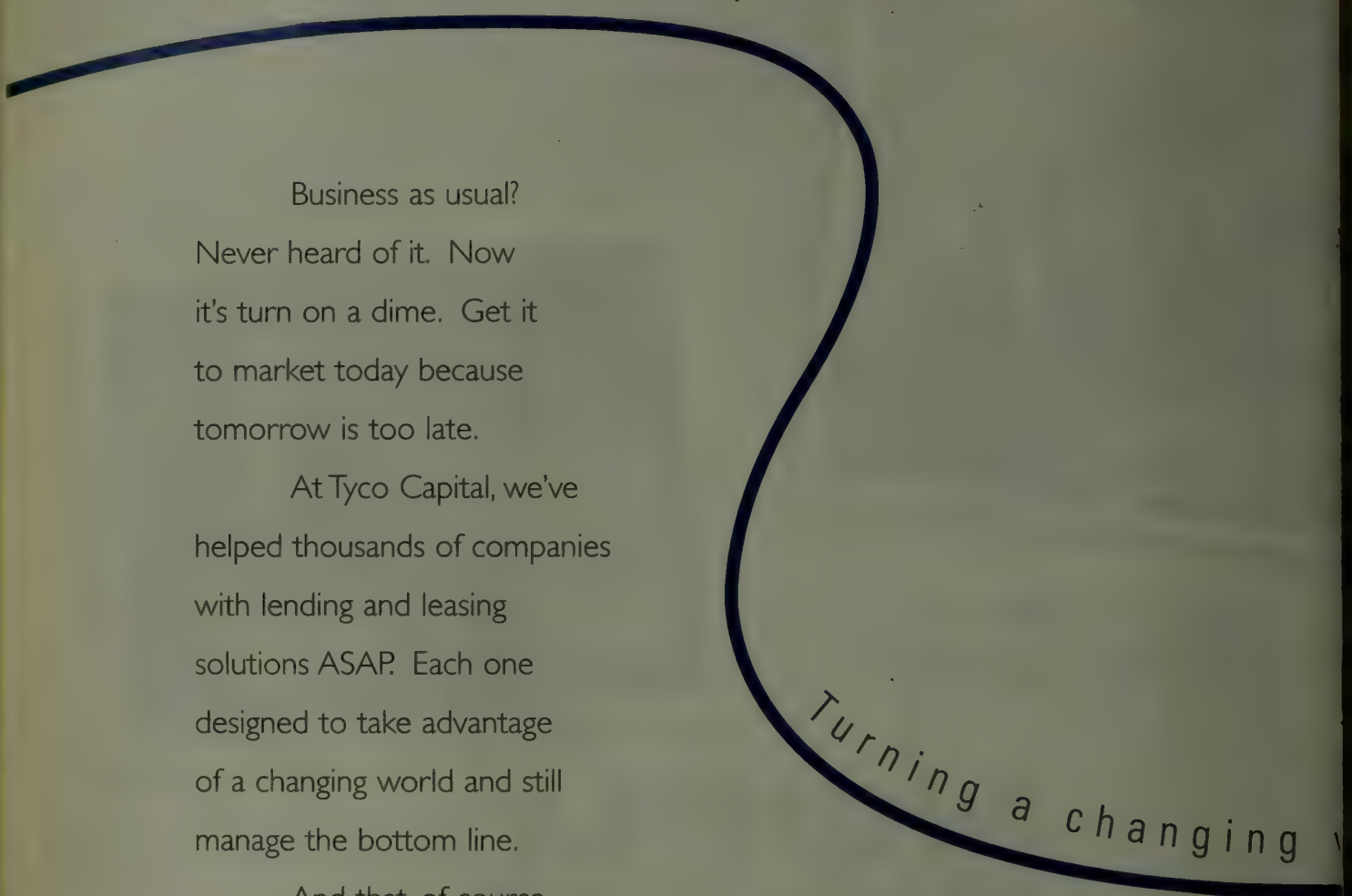
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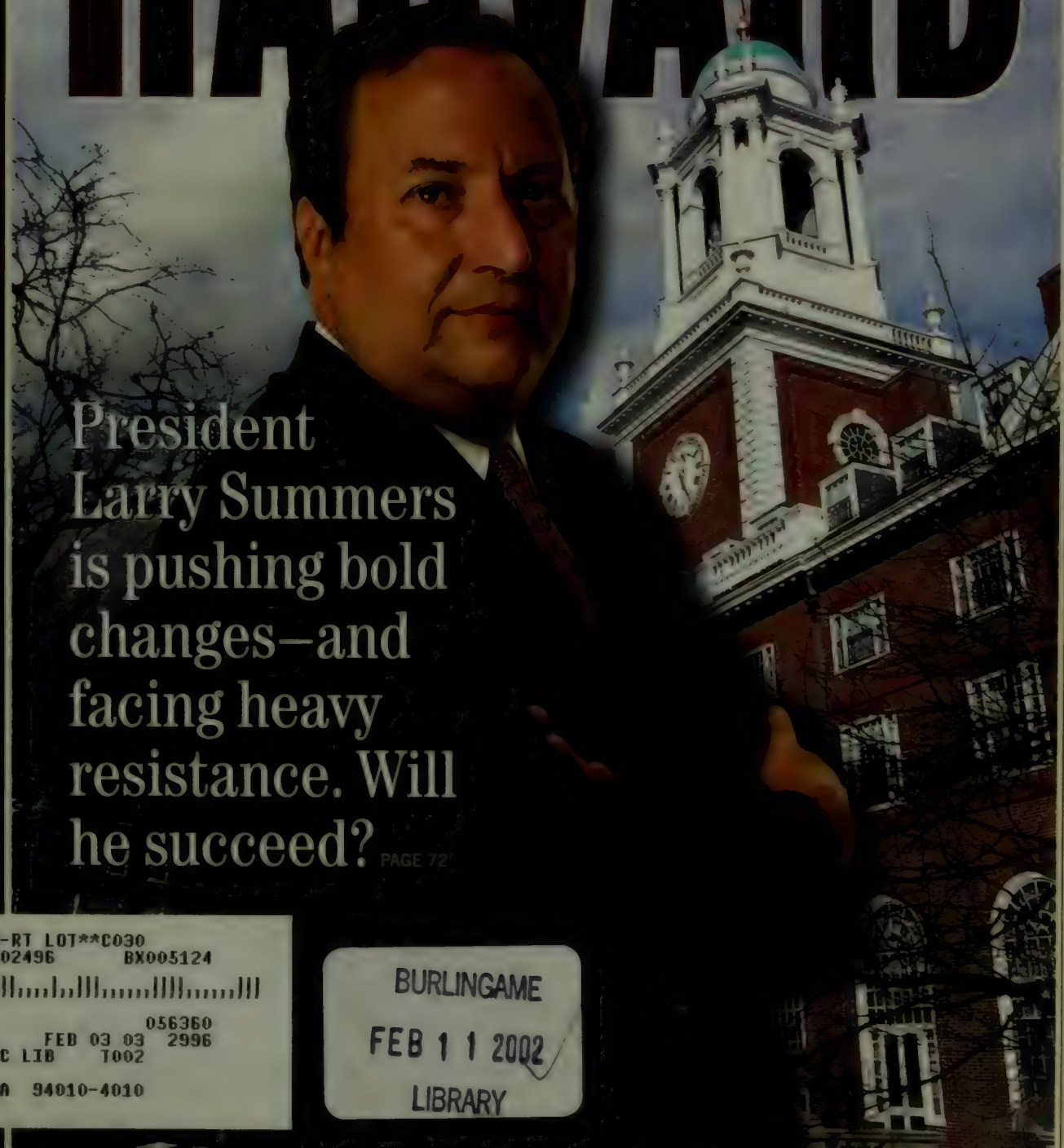
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President
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is pushing bold
changes—and
facing heavy
resistance. Will
he succeed?

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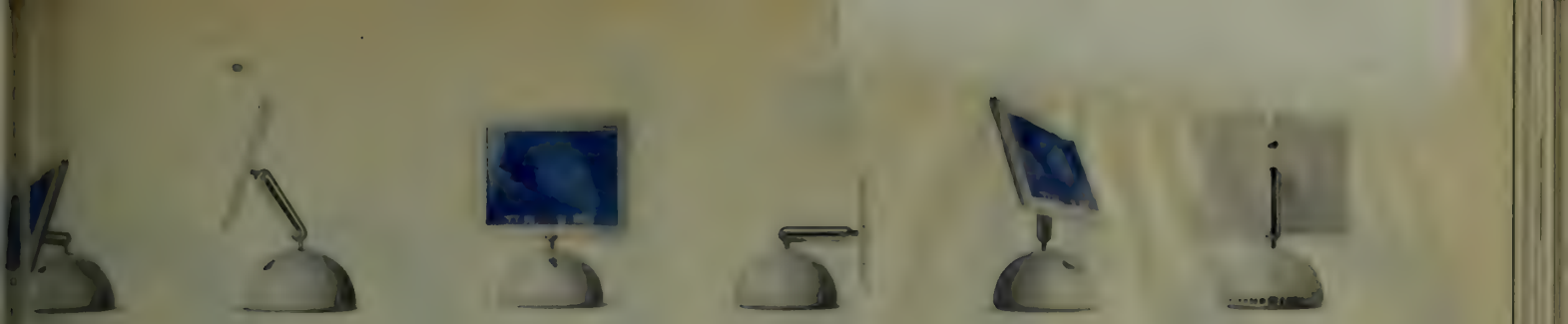
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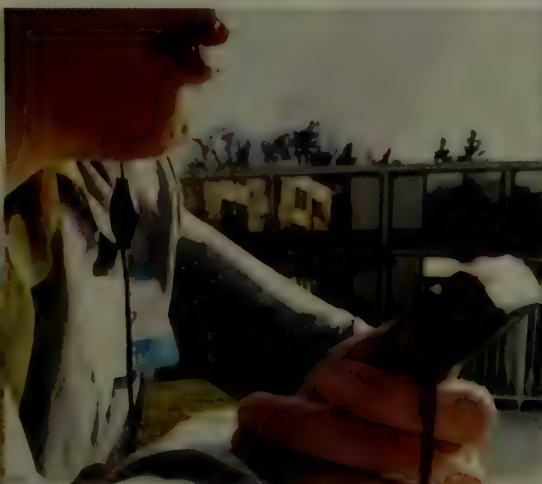
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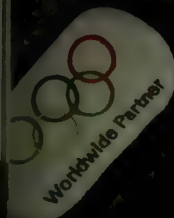


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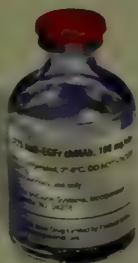
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New President Larry Summers has his critics seeing red

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As the new president of the nation's leading university, former Treasury Secretary Lawrence Summers plans nothing short of an overhaul. He wants to stiffen grading, transform tenure reviews, persuade professors to spend more time with undergraduates, and nearly double the size of Harvard's campus. But given the virtual autonomy of the university's 12 schools and colleges, he'll need to persuade a lot of ego-driven people to join in the quest. Does he stand a fighting chance?

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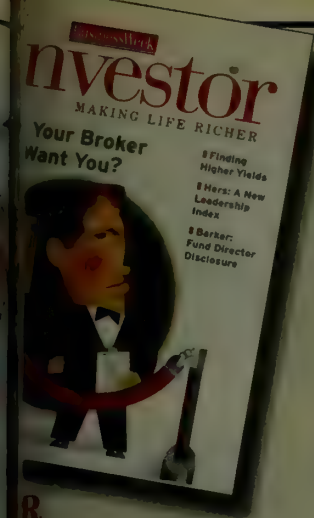
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One Year After

How goes the "revolution" that AOL Time Warner promised? The obstacles have proven greater—and the payoff further away—than Case & Co. expected



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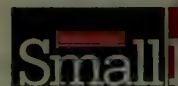
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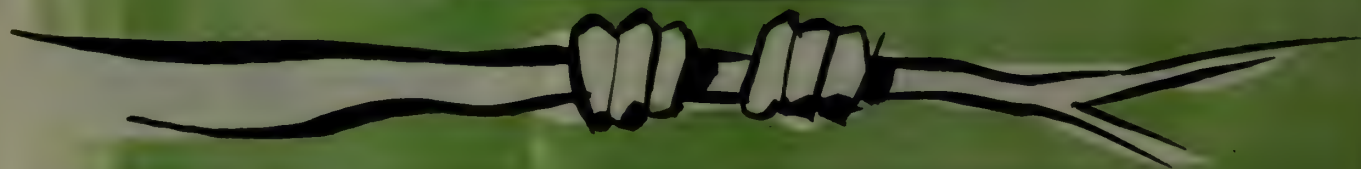
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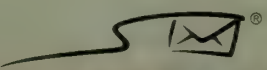


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BEAN COUNTERS

KENNETH LAY, ACCOUNTING EXPERT

ONCE UPON A TIME, ENRON CEO Ken Lay was an adviser on accounting. At the height of the technology boom, the Securities & Exchange Commission wondered whether companies should be divulging more information about intangible assets—such as brand names or Web traffic—that don't show up on financial statements. So it commissioned Yale School of Management Dean Jeffrey Garten, who is also a *BusinessWeek* columnist. He set up a task force of 14 experts, including venture capitalist John Doerr, Goldman Sachs tech analyst Richard Sherlund, economist Joseph Stiglitz—and Lay.

The panel released its findings in May, 2001. It stopped short of requiring more disclosure, and recommended more study. *BusinessWeek* spoke with several panelists



LAY: Former SEC adviser

who don't recall Lay playing a big role in the discussions. "I didn't even realize Ken Lay was on the commission," says one panelist. Garten would not comment. Lay, through a spokeswoman, said only that he agreed with the commission's recommendations. As with many reports in Washington, this one sank without a trace. *Kimberly Weisul and Mike McNamee*

GIFT:
Pack o'
money

Yimeijia market has been selling 200 to 300 sets a day. Says another trader: "It's new in China, so it's special and fun for the kids."

But there may be more afoot than New Year's packets. Officials at China's central bank, The People's Bank of China, have said they plan to buy more euros, which would reduce China's dependency on U.S. dollar reserves. Currency traders in London and Frankfurt have been buzzing with rumors that it's starting. Certainly, the euro could use the help. It hit a year-low of 85.6¢ on Feb. 1. But at the Yimeijia market, where gift sets start at \$7, a euro costs a minimum of \$1.68. That should bring smiles at the European Central Bank. *Mark L. Clifford and Li Yan*



COIN OF THE REALM

CHINA'S YEAR OF THE EURO?

COULD THE EURO GET A BOOST from China? Ahead of Chinese New Year, which begins Feb. 12, trend-setters in Beijing and other Chinese cities have been stuffing the red envelopes traditionally given to children with euro coins purchased in China's thriving coin-and-stamp bazaars. Even though the country has strict currency controls, vendors sidestep them by packaging euros as collectable gift sets. Trader Xu Kai at Beijing's

TALK SHOW "Starbucks is now offering an Enron lat just skim the cream right off the top."

—Jay Leno, The Tonight Show

STATELY MATTERS

BUILDING A BUZZ FOR THE BEEHIVE STATE

UTAH GOVERNOR MIKE LEAVITT went whole hog to lure the Winter Olympics to Salt Lake City. Now he wants to capitalize on it to lure businesses, too. Leavitt spent three weeks in January following the Olympic torch relay to cities such as Seattle and San Jose, hosting parties for companies he hopes will bring in new investment. And perhaps to help change the state's conservative image, he staged a Los Angeles event at the House of Blues nightclub. Leavitt, a Mormon, even sprang for an open bar.

During the Games, Utah is providing free tickets to 200 CEOs and venture capitalists. Then, after the Games end on Feb. 24, Leavitt will kick off what he calls a "1,000-day plan" for his last three years in office, with corporate recruiting missions to various cities.

Leavitt also plans to make Utah attractive to high-tech

talent by spending more than \$42 million on ships, teacher incentives, new facilities at Utah universities. He cites the promotion of technologies on the TV by Utah native



UTAH HOOPLA: New in

moved elsewhere. "I've seen ten...the jobs went to place else," Leavitt said in a recent address. "We need to change that."

Christopher Palmer and Arlene Weintraub

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Thought you deleted those sensitive files? So did Enron employees and even operatives for Osama bin Laden. But all kinds of documents can lurk in your hard drive even after hitting "Delete." File-wiper software promises to erase them for good.

PROGRAM	HOW TO GET IT/COST
BCWIPE	Jetico.com says its program meets Defunct Dept. specs (which call for files to be overwritten seven times with random data). Cost: \$29.95.
DESTROY-IT!	Business Logic Corp. (blcorp.com). Offers "bulletproof file shredding." \$29.95.
DATAERASER	Ontrack.com. Personal version, \$29.95; professional version, \$500—which can be configured to overwrite files up to 99 times.
EVIDENCE ELIMINATOR	From evidence-eliminator.com. Claims to defeat the same forensic software used by the U.S. Secret Service, Customs, and the LAPD; \$149.95.

Data: Texas Lawyer, product Web sites



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Up Front

WRETCHED EXCESS

AND NOW, THE \$21,000 CELL PHONE

THE FERRARI-DRIVING, ROLEX-flashing crowd has had reason to grouse: Even the snazziest of cell phones are made from the basest materials, mostly plastic. Pure plebe-ware. But relief is on the way. By summer, Nokia's new subsidiary Vertu will launch luxury cell phones. Encased in platinum or 18k gold, with crystal screens and soft leather casings, the phones will sell for up to \$21,000. For tightwads, \$5,200 versions will be available in stainless steel.

Extravagant? Precisely. Vertu is betting that cell phones will follow the evolutionary path of the



LOW TECH
but 18k gold

watch, from functional time-piece to gold-encased prestige item. The company will market to the moneyed elite in boutiques from Hollywood's Rodeo Drive to New York's Madison Avenue. It's all the brainchild of Nokia design chief Frank Nuovo. "Think of a Rolls-Royce," he says. "These phones will be built to last."

So the trick will be keeping up with technology. Vertu will contact clients to offer regular upgrades. But gadget freaks beware: The phones lack many features such as an Internet browser. Instead, users anxious to book a table at Taillevent or a seat on the Concorde can push a button for multilingual help from a live human. Low tech, yes, but luxurious. *Stephen Baker*

SEPTEMBER 11

A PLAGUE OF HATE SITES

UNTIL RECENTLY, ONE OF THE biggest Internet-related worries for companies was employees who surfed the Web for cybersmut. Now, there's another concern: hate sites. The number of these venomous domains—which in the past featured gay-bashing, neo-Nazism, and misogynist rants—has doubled since September 11, to about 2,000, according to Websense, a San Diego software-monitoring company.

Growth is mainly due to a new niche: anti-Arab and anti-Muslim sites. Among them is crisis2001.com. Rich in racial epithets, it calls Islam "the

scourge of the earth" and rallies to "nuke" them all. Another, you-got-mail.com, talks about "Satan's Muslims" and says it's "time to lock up the mosques and kick those dirty Muslims out." Others, such as nuke-kabul.com, are anti-Afghanistan and anti-Osama bin Laden in nature.

Employment lawyers say it's important for companies to remind workers of policies that bar viewing hate sites in the workplace. Warns Jennifer Kearns, a partner in San Francisco law firm Brobeck Phleger & Harrison: "Otherwise, you're kind of a sitting duck for a hostile-workplace suit."

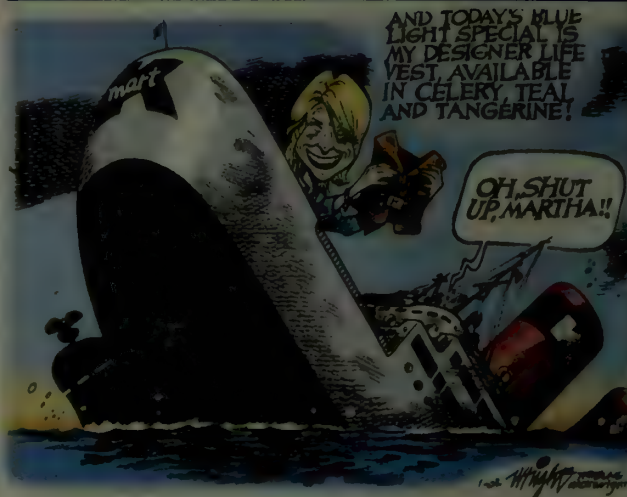
Michelle Conlin

MUSLIM:
Web-bashed



Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com

DRAWN & QUARTERED



THE MONEY GAME

HICKS MUSE'S NOT-SO-EXCELLENT VENT

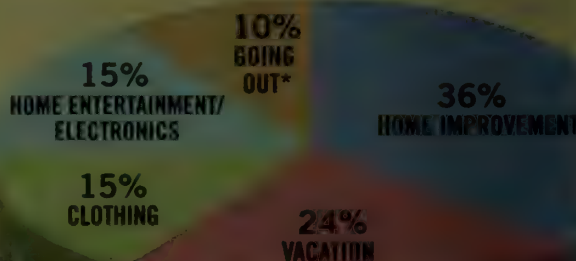
TO DALLAS BUYOUT FIRM HICKS, MUSE, TATE & FUND, \$1.6 billion must seem like a paltry sum. Hicks, which has a name on such spectacular successes as Dr. Pepper International Home Foods, had hoped to raise \$4.5 billion in its latest fund. Like other buyout shops, Hicks planned to use the money to take big stakes in struggling companies, then sell the companies around and sell them at a profit. Instead, two years, Hicks in December quietly pulled the fund-raising. At just \$1.6 billion, Hicks declared its fund closed to investors, private equity bankers say.

True, the fund-raising environment has been lousy. Missteps tarnished the firm's image and likely played a role in its failure to get more cash. "Investors are going to be twice about any firm that has troubled portfolio companies," says Mario Giannini, president of Hamilton Lane Associates, which helps institutions pick investments. In 1999, Hicks strayed from the food, consumer, and manufacturing sectors and invested in telecoms, pouring at least \$700 million into four companies that later filed for bankruptcy. Then Hicks lost \$500 million when another investment, Regal Cinemas, went bankrupt. Hicks execs declined comment. But the firm has recently said it plans to go back to its roots. *Kimberly*

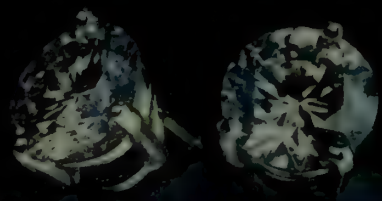
THE BIG PICTURE

URGE TO SPLURGE

Americans say they would spend an unexpected \$1,000 windfall on:



*TO DINNER, A MOVIE, ETC.
SURVEY OF 1,000 ADULTS, OCT. 28-29
Data: Ipsos-Reid



IT'S JUST
LIKE BUYING
HER ROSES.
150 DOZEN ROSES.



A DIAMOND IS FOREVER

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ENRON: WHAT OUGHT TO BE DONE

Our ongoing "Enron Watch" and our Jan. 28 Special Report, "Accounting in crisis," prompted many reader letters on the implications for corporations, auditors, government, and investors, as well as a myriad of recommendations for reform.

A VICTIMS' FUND

As I read your excellent coverage of Enron Corp.'s deceit, I can't help but see those responsible as domestic enemies. Their devastation of families is of a different order than the attack on New York, of course, but the consequences are dire nonetheless.

I would like to see Chairman Kenneth L. Lay, former CEO Jeffrey Skilling, former Chief Financial Officer Andrew Fastow, members of Enron's audit committee, top officials of Enron, and the partners at Arthur Andersen and Vinson & Elkins personally repay what they stole. I would like to see President George W. Bush, White House Economic Adviser Lawrence B. Lindsey, and Vice-President Dick Cheney speak as plainly and as forcefully about this domestic evil as they do about foreign terrorists. Enron's damage to individual lives, to the national well-being, to confidence in the economy and the stock market is criminal. Those responsible should pay for it.

I recommend a victims' fund. This time, it would not come from millions of citizens touched by tragedy, nor from a government too ready to bail out its cronies. It would come from the individual Republicans and Democrats whose campaigns were financed by Enron. It would come from the pockets of

Lay, Skilling, Fastow, Anders v&E. It would be reimbursed by act amounts of campaign contributed out so liberally for so many. And it would be started by President Bush himself, with a contribution from his pocket—no spin allowed.

Let no tort lawyers get rich as the victims are further impoverished. Get the money directly and quickly from the victims and show the world that this naked indifference to American citizens "will not stand."

Linda M. Ne

REGULATORY FIXES

Just like the banking industry, we need an independent group similar to the Office of the Comptroller of the Currency (placed under the Securities and Exchange Commission) to audit auditors and management of public companies. The companies (and

accounting firms) should pay fees for the review of the cost to be a public traded company, like how banks pay fees to the

The good news is that we have already identified the person capable of leading this new effort. Her name is Sherron S. Watkins.

Kathryn M. B. Lancas

Reform No. 1: Bar Congress from tinkering with the accounting rules. Several years ago, the savings and loans had an accounting problem. The Accounting Principles Board recognized the fees for sales of portfolios over the original life

**ENRON
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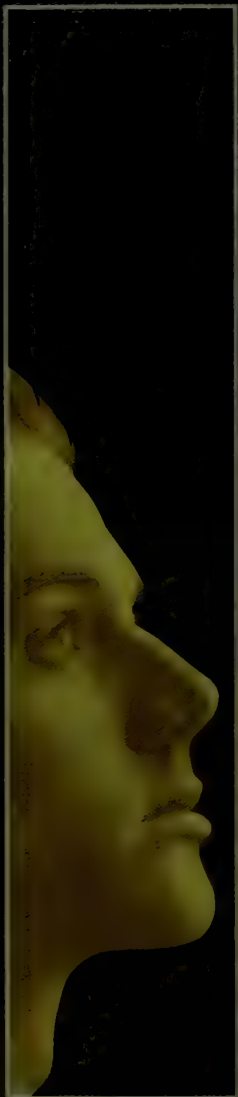
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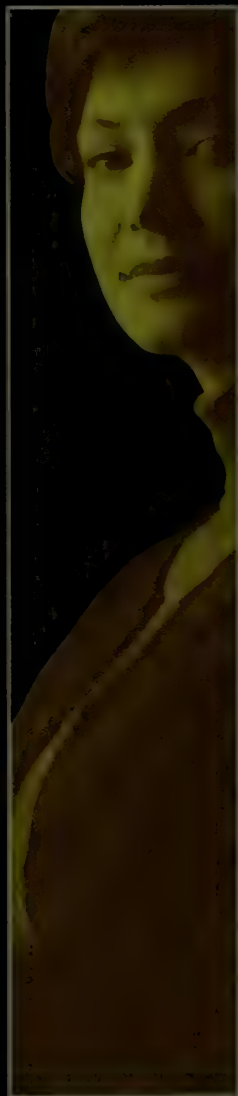


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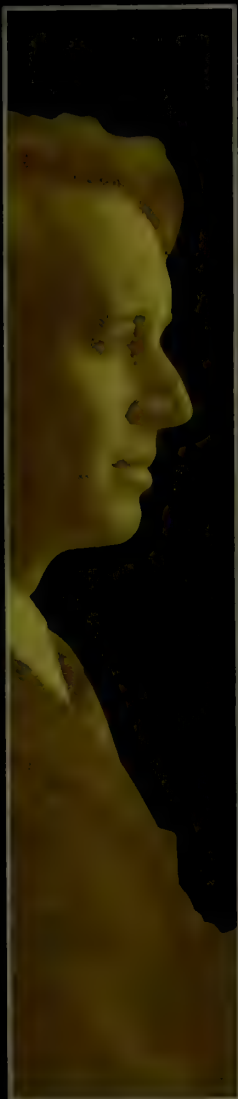
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Readers Report

loan. They went to Congress and asked for legislation barring the APB's jurisdiction so they could count as current income the entire "fee" they received by discounting the loan portfolio sold to another S&L. The got their way. You know what happened.

Stephen D. Tanner, CPA
Morgantown, W. Va.

Another reform that would "re-establish the public trust" is to have the responsible corporate officers, directors, and outsider auditors placed in jail. We will not get meaningful reform in this country until these "blue-suited thugs" do time.

Steven Kallos
Villas, N.J.

Auditors should be assigned by and beholden to the SEC (and indirectly to shareholders), not the company under audit. Corporations would pay an annual "audit fee" to the SEC based on accounting complexity. The SEC would select auditors from a pool of talent to conduct "tough audits." A new auditor would be assigned each year. Audit committee "watchdogs" would be selected from a pool of qualified candidates [for two-year terms] to oversee the auditors. If an audit or "watchdog" missed a significant problem that led to an "Enron-like" meltdown, they should face penalties for incompetence.

R. Dellar
Chicago

PROFESSIONAL CREDIBILITY

The essay by Bruce Nussbaum, "Can you trust anybody anymore?" was the best description of the causes and potential consequences of the Enron debacle that I have read to date. The essay captured the essence of the scandal and the character and motivations of the major players. Bravo!

Michael Weisberg
Gainesville, Fla.

The big [accounting] firms control our professional organizations and shape policy and direction because of their great influence in terms of size and money. But all too frequently these days, their greed and influence disgrace all of us.

Andersen should be hung out to dry.
Robert P. Bozajian, CPA
Tarzana, Calif.

Nussbaum's comment—"In short, most certified public accountants feel

little duty to the public at large"—shows a great deal of ignorance as to what the peer review process means to the approximately 45,000 CPAs who are members of the American Institute of Certified Public Accountants and who are employed by Big Five firms and who have probably never audited a large public company. I have served for almost 15 years on my state's Peer Review Committee, and I am currently



serving on the AICPA Peer Review Committee. Our process of having firms that perform audits undergo a peer review every three years does weed out firms who are not keeping up with accounting standards. Please don't disparage approximately 95% of a very trustworthy profession in one fell swoop.

Michael Solakian, CPA
Branford, Conn.

Why should any regulatory body demand oversight of certified public accountants or require the protections of the Glass-Steagall Act when they benefit from the immense dollars thrown at them to ignore such things, for what else is lobbying?

Alan E. Rosenfield
Scottsdale, Ariz.

DANGERS OF SELF-REGULATION

As an AICPA member, I recently received a letter from its chairman and its president stating that "the accounting profession has a successful 100-year tradition of self-regulation, which has contributed to the most respected financial reporting system in the world." Perhaps those green eyeshades have blinded our profession to the realities of the 21st century.

Stanley J. Brunman
Hillsdale, N.J.

Our federal government is irrelevant to the task of promoting integrity in accounting firms. We investors can do it ourselves. I have purged my portfolio of the stock of any company audited by Arthur Andersen. If other investors will do the same, the accounting profession will rediscover honesty.

Paul Doering
Rochester, N. Y.

One would expect that those who have the most to benefit from the free-

market system would be the last detractors of market integrity. Unfortunately, the actions of the executives at Enron, Andersen, and other companies before them show that the strikes from within. Unless demand and free-market societies strive to develop a market ethos among members, the sorry tale of Enron and Andersen will be repeated many times in the future.

George J. Papaio
Hofstra Univ.
Merrick

THE STOCK MARKET'S INFLUENCE

One contributing factor to financial reporting problems at Enron and other companies with overstated earnings is the heavy dependence on compensation management and board members with stock option grants. Grants usually avoid a charge to earnings when options are granted or exercised but provide a tax deductible expense—an accounting anomaly that distorts true operating expenses.

If management stock ownership is desirable—and I believe it is—grant shares outright, make them part of the compensation package, and let current earnings accordingly.

Kurt W.
King of Prussia

You point out the subversive nature of the "enormous pressures to increase earnings growth"—and to increase the company's stock price. The Undistributed Profits Tax of 1936 [was] one of the most useful post-1920s reforms. A new UPT would encourage more dividend payouts. That would help the stock market "booms" and subsequent crashes, help refocus corporate strategy from stock appreciation to productive investment, encourage more transparent and honest corporate accounting, reduce merger mania, help address "bigness gives political access" problem, and bring back corporate dividend as a source of supplementary retirement income. Although the 1936 act made wealthy income subject to regulation, it reduced other corporate taxes.

John S.
Institute for Economic Analysis
Brattleboro

CONTROL OF 401(k)s

In typical 401(k) plans, there is an appointed fiduciary, or board of trustees, or some governing body that in turn is solely and exclusively responsible

RECTIONS & CLARIFICATIONS

new way to squeeze the weak" (Finance, 28), on insurers' use of credit scores, would have referred to property and casualty insurer Farmers Insurance Co. of Irvington, not Farmer's Bureau.

Was Microsoft met its match?" (Information Technology, Feb. 4), the percentage of users of competing Web browsers up to more than 100 because many use more than one browser.

members of the plan. The obvious point at Enron points out an even larger consideration: Who controls all the plans in the U.S.? Most plans are owned exclusively by corporate [appetites]. With \$10 trillion in U.S. pensions, we had all better be asking who is in control and whether they are representing our interests.

Richard L. Hannah
Middle Tennessee State University
Murfreesboro, Tenn.

LINKING THE ENERGY PLAN

The Enron crisis has cast serious doubt on the validity and integrity of the administration's energy plan. Lay

was one of the principal architects of the plan. One can only speculate as to what his specific contributions were. It is essential that the Administration make public the details of how this plan was formulated and that a review of the plan and its underlying assumptions be conducted by an independent panel.

Lisa Buckles
Newbury, Ohio

The press has been making much of the fact that the Bush Administration in October, 2001, when Ken Lay supposedly asked for help, refused. Was this the right thing to do? By then, the "big boys" had already gotten their money by selling the stock that summer—the only people left to feel the brunt of the bankruptcy were the employees and other small investors. An Administration that cared about these people would have tried to right the wrong instead of washing its hands of the mess.

Lawrence R. Dworkin
Wallingford, Pa.

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THE



EXPERIENCE

TOBACCO

A Cultural History of How an Exotic Plant Seduced Civilization

By Iain Gately

Grove Press • 403pp • \$25

THE VIOLENT PAST OF A WICKED WEED

Today's smokers, shivering in the winter cold outside their smoke-free office buildings, should be glad they aren't living in Constantinople in the early 1600s. That's when Murad IV, ruler of the vast Ottoman Empire, had an even nastier habit than tobacco. He roamed the city's streets in disguise, "feigning an urgent craving for a smoke, then beheading any good Samaritans who offered relief," reports Iain Gately in his entertaining *Tobacco: A Cultural History of How an Exotic Plant Seduced Civilization*. In just 14 years, Murad personally killed or had put to death more than 25,000 suspected smokers.

Who would have guessed that the antismoking movement had such a long and colorful past? Murad's methods might have been extreme, but he wasn't the only fervent foe of the pervasive weed. England's King James I wrote that smokers were no better than devil-worshipping savages "guilty of sinful and shameful lust," and he tried to tax tobacco into oblivion. New Year's Day in 1848 kicked off the "greatest no-smoking protest of the nineteenth century" in Milan. Citizens knocked cigars from the mouths of smokers—even the Austrian soldiers who were occupying Italy. "It was the first blow struck for a free and united Italy," the author writes. And as cigarettes became popular, *The New York Times* warned in 1883 that "if this pernicious practice obtains among adult Americans the ruin of the Republic is at hand."

As Gately argues in this irreverent and quirky, if occasionally exaggerated, book, tobacco not only survived every attempt to stamp it out, it changed the course of history. Gately claims—not altogether persuasively—that the American colonies were founded and fueled by tobacco. It was John Rolfe's 1612 planting of tobacco that saved the

foundering Jamestown colony and created a cash crop that dramatically boosted English interest in the New World. That act "was ultimately responsible for the pre-eminence of English culture, language and laws in the most powerful...nation in history," Gately writes.

Aptly enough, the original Native American name for what is now Greenwich Village was *Sapponckanican*: the land where tobacco grows. The crop became North America's main export and helped create a demand for slaves. And by being both the subject of British taxes and the collateral for a loan Benjamin Franklin got from France, "tobacco supplied both the cause and the victory in the U.S. War of Independence," Gately argues.

Gately describes how cultivation originated in the Peruvian and Ecuadorian Andes between 5000 and 3000 BC. Shamans smoked, chewed, ate, or drank it to achieve near-death trances. Long before the white man, tobacco spread throughout the New World, showing up in creation myths and social rituals. Even North American Plains Indians, who grew no other crops, planted tobacco. When he arrived, Columbus was presented with gifts of the weed. He threw the stuff overboard, but others were quickly hooked. "Tobacco spread like an epidemic...crossing borders and cultures at will," Gately writes. "It respected neither rank nor creed, infecting nomads, Buddhists and Christian bishops alike."

The book is filled with fascinating tidbits. The Dutch so embraced the new plant's purported medicinal qualities that "infant pipe smokers were counted as one of the curiosities of seventeenth century Amsterdam." Napoleon used a kilo of snuff a week—equivalent to a

hundred-cigarette-a-day habit. Cautious on whether this hurt or helped his military strategy, though he did note that Napoleon's British foes fit the cavalry "world renowned for its beauty, and senselessness."

In the U.S., the mighty tobacco industry grew from the vision of a man named Buck Duke, whose factory employed the first mass-produced cigarettes. By the late 1880s, Duke was making 2 million cigarettes a year, spending an astonishing \$800,000 a year on advertising. His American Tobacco Co. became powerful enough to persuade Congress not to include tobacco on the list of drugs subject to the 1906 Federal Food & Drugs Act.

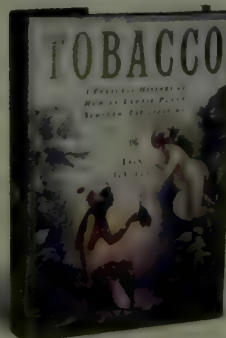
Yet the nascent industry still faced substantial opposition. Henry James rallied against cigarettes, which he called the "little white slaver," and Thomas Edison refused to hire cigarette smokers. Because Pittsburgh Pirates pitcher Honus Wagner ordered American Tobacco to take his picture off

baseball cards, these cards became extremely rare and valuable. But Gately documents how smoking got a huge boost from world war. Tobacco's ability to calm nerves, suppress hunger, and provide a moment of calm during the horror of the trenches made it "as indispensable as any ration," said U.S. Surgeon General John J. Pershing. President Franklin D. Roosevelt even declared tobacco an essential wartime material. By 1949, the percentage of British men who were hooked on the weed rose to 70%.

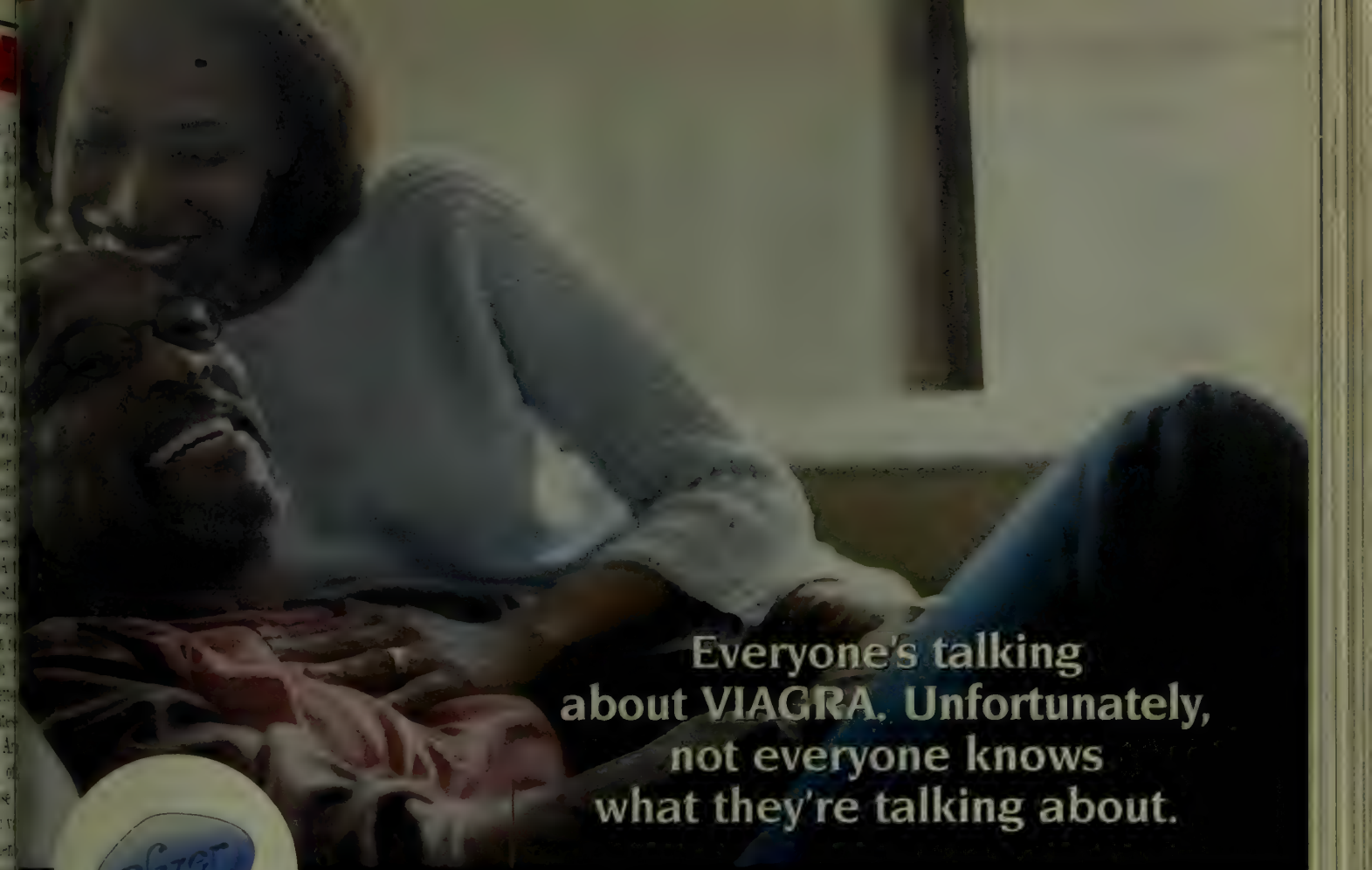
Today, smoking's foes have more strength in the U.S.—perhaps to Gately's surprise. "To the lion smokers of the world, tobacco is not just a killer, but a pleasure, a comfort and a friend," he argues. "This is one of the few junctures where he attempts to tackle the larger issue of this plant and its extraordinary ability to addict and harm thousands who fall for its allure. Instead, for the most part, he delivers a dizzying—and haphazardly organized—recitation of facts. Tobacco's often bizarre past is not as clear as day—but the big questions remain veiled in smoke."

BY JOHN

Carey covers science from Washington



GATELY ARGUES THAT TOBACCO BOTH SPARKED THE AMERICAN REVOLUTION AND AIDED THE TRIUMPH OF U.S. INDEPENDENCE



Everyone's talking
about VIAGRA. Unfortunately,
not everyone knows
what they're talking about.



You've heard about VIAGRA (who hasn't?).
But did you know:

With VIAGRA, you can be in control.

VIAGRA doesn't give you an instant erection. It just allows you to respond to sexual stimulation. What's more, VIAGRA works in as little as 30 minutes and stays ready to work up to 4 hours. So you can enjoy intimacy when you both are ready.

With VIAGRA, you have a proven treatment.

VIAGRA works in 4 out of 5 men who use it for erectile dysfunction (vs 1 in 4 treated with a sugar pill). That's why **more than 9 million men** have already turned to VIAGRA.

To learn more, call 1-888-4VIAGRA or visit
www.viagra.com.

VIAGRA
(sildenafil citrate) tablets

Join the millions. Ask your doctor if a free sample is right for you.

VIAGRA is indicated for the treatment of erectile dysfunction. Remember that no medicine is for everyone. If you take nitrates, often used to control chest pain (also known as angina), don't take VIAGRA. This combination can cause your blood pressure to drop to an unsafe or life-threatening level.

Discuss your general health status with your doctor to ensure that you are healthy enough to engage in sexual activity. If you experience chest pain, nausea, or any other discomforts during sex or an erection that lasts longer than 4 hours, seek immediate medical help. The most common side effects of VIAGRA are headache, facial flushing, upset stomach. Less commonly bluish vision, blurred vision, or sensitivity to light may briefly occur.

Please see patient summary of information for VIAGRA (25-mg, 50-mg, 100-mg) tablets on the following page.



PATIENT SUMMARY OF INFORMATION ABOUT

VIAGRA

(sildenafil citrate) tablets

This summary contains important information about **VIAGRA**. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking **VIAGRA**. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about **VIAGRA**. This medicine can help many men when it is used as prescribed by their doctors. However, **VIAGRA** is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated). You will not get an erection just by taking this medicine. **VIAGRA** helps a man with erectile dysfunction get an erection only when he is sexually excited.

How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, **VIAGRA** helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates—either regularly or as needed—you should never take VIAGRA.

If you take **VIAGRA** with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. **VIAGRA** is not for newborns, children, or women. Do not let anyone else take your **VIAGRA**. **VIAGRA** must be used only under a doctor's supervision.

What VIAGRA Does Not Do

- **VIAGRA** does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- **VIAGRA** does not protect you or your partner from getting sexually transmitted diseases, including HIV—the virus that causes AIDS.
- **VIAGRA** is not a hormone or an aphrodisiac.

What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if **VIAGRA** is right for you. **VIAGRA** can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take **VIAGRA** alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, or heart attack)
- have ever had a stroke
- have low or high blood pressure
- have a rare inherited eye disease called retinitis pigmentosa

- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of **VIAGRA** tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

VIAGRA and Other Medicines

Some medicines can change the way **VIAGRA** works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies. Remember, **VIAGRA** should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*). If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*). **VIAGRA** should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more **VIAGRA** than your doctor prescribes.
- If you think you need a larger dose of **VIAGRA**, check with your doctor.
- **VIAGRA** should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of **VIAGRA**. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of **VIAGRA** in a 48 hour period.

How To Take VIAGRA

Take **VIAGRA** about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, **VIAGRA** can help you get an erection if you are sexually excited. If you take **VIAGRA** after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. **VIAGRA** can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

Possible Side Effects

Like all medicines, **VIAGRA** can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of **VIAGRA** are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking **VIAGRA**. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to **VIAGRA**.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

Accidental Overdose

In case of accidental overdose, call your doctor right away.

Storing VIAGRA

Keep **VIAGRA** out of the reach of children. Keep **VIAGRA** in its original container. Store at room temperature, 59°-86°F (15°-30°C).

For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about **VIAGRA**, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

23-5515-00-4

June 1999

VIAGRA[®]
(sildenafil citrate) tablets

Books

BY BUSINESSWEEK WRITERS

CHINA AND THE WTO

Changing China, Changing World

By Supachai Panitchpakdi and Mark L. Clifford

Wiley • 251pp • \$21.95

JOINING THE CLUB

Arguably the most significant development in international commerce last year was the entry of China into the World Trade Organization. In *China and the Changing World*, Asia Regional Editor Mark L. Clifford teams up with Thailand's former Deputy Prime Minister Supachai Panitchpakdi, who will become the WTO's director general in September, to assess the impact that this will have on the world market and within China's borders.

For the most part, the authors believe that there will be enormous benefits—not the least of which is that the world's largest and fastest-growing emerging economy will now operate under internationally accepted rules. But they are careful not to downplay how dicey the situation could become. As China opens its market, foreign products could flood in, crippling already weak state and agricultural sectors and fermenting unrest.

Written in an accessible fashion, the book has chapters on why it took China 15 years to get into the WTO and on the effect its entry will likely have on economic reform at home. In a chapter called "The Asia Puzzle," the authors consider various possible consequences of WTO entry on China's neighbors. Will it make the region a more attractive place for foreign investment or will it "bolster the country's already formidable competitive position at the expense of the rest of the region?"

No doubt, the next few years will continue to be disruptive. China moves toward a market economy. But in the end, the authors agree that "it's China's people, and its economy, who will be the biggest winners."

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EPHEN H. WILDSTROM

ou@businessweek.com

THE NEW PALM: A WIRELESS WONDER



i705 has
the classic
features.
it can't
ch
BlackBerry
e-mailing

During the development of the original Palm Pilot in the mid-1990s, designer Jeff Hawkins demanded that everything be kept simple to the point of declaring that anything that generated error messages was unacceptable. This focus on simplicity and usability became known as the Zen of Palm and played no small role in the product's success.

Palm has faced pressures (and I will admit that I have contributed to them) to add functions to its handhelds, even though doing more is the enemy of simplicity. The new Palm i705, the sleek wireless successor to the clunky Palm VIIx, is an ambitious effort to do more. The classic Palm features, such as the address book and calendar, are as simple and intuitive as ever. The wireless e-mail, the product's reason for being, is another story.

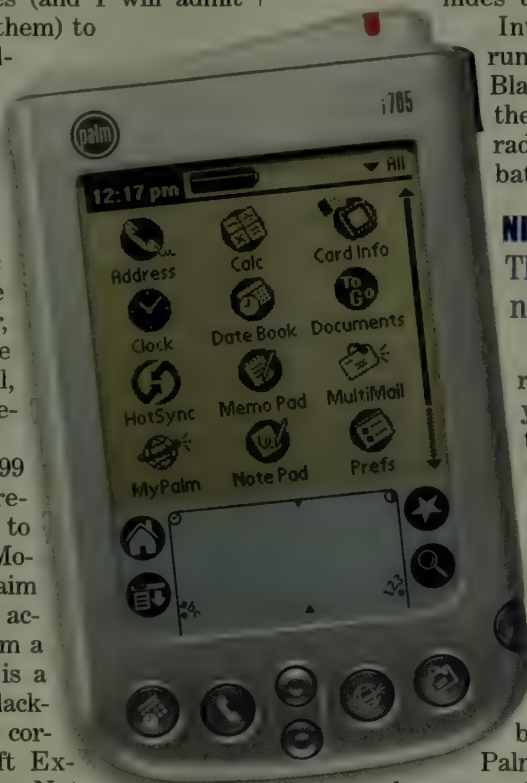
The i705 (\$449, plus \$39.99 a month for unlimited wireless service) was designed to compete with Research In Motion's BlackBerry, whose claim to fame is providing simple access to corporate e-mail from a wireless device. The Palm is a lot more flexible than the BlackBerry. The i705 lets you get corporate mail from Microsoft Exchange servers (a Lotus Notes version is planned) as well as mail from standard Internet accounts and from a special Palm.com account. AOL Instant Messenger is also included. With BlackBerry, you have to buy separate versions for Internet and corporate mail or for AOL.

In contrast to the BlackBerry, however, I found setting the Palm up for corporate e-mail a challenge. The mail-forwarding software, which runs on your desktop PC, has to be downloaded from the Web. That's an indication that it was not finished in time to be included on the CD that comes with the i705, and the program shows signs of inadequate testing. The first version would not install on my computer because it connected to the Internet through a security mechanism called a proxy server, a common arrangement for corporate PCs. A hurriedly compiled replacement worked, but was clunky to in-

stall and set up. And any configuration problem produces that most unfamiliar of things on a Palm, a baffling message like "Wireless INetLib Error." Palm plans to offer software that lets corporations forward mail directly to i705s from Exchange servers sometime this summer.

The software difficulties are unfortunate because the i705 is a nice piece of hardware. At 4.7 in. long, 3.1 in. wide, and 0.6 in. thick, it is just a little longer and thicker than the Palm m500 and weighs just 5.9 oz. An optional keyboard (\$29 with an i705 purchase) slips over the bottom of the Palm and allows you to type instead of writing in the usual Graffiti shorthand. It works well, but is not as convenient as the integrated BlackBerry keyboard.

Unlike the Palm VIIx, which required flipping up an awkward antenna to activate wireless, the i705's radio can stay on all the time, allowing it to download mail in the background. This hides the fact that the Cingular Interactive network that it runs on, the same used by BlackBerry, is very slow. But the downside of an always-on radio is a heavy drain on the battery. If you schedule the



NICE HARDWARE, THOUGH
The sleek, trim i705 just needs a good debugging

radio to turn off overnight, you can probably squeeze three days' use out of a charge. The best approach is to treat the i705 like a cell phone and plan to recharge it every night.

Unlike the BlackBerry, whose contact and calendar functions can charitably be called primitive, the i705 comes with the built-in applications that Palm users have come to love,

plus access to a huge library of games, expense tracking programs, reference works, and other applications. The i705 includes Palm's MultiMail e-mail program, DataViz's Documents-to-Go for reading and editing Microsoft Office files, and a Web browser, though the small screen and the slow network make for a painful combination. The i705 also supports all of the simplified "Web clipping" applications designed for the Palm VII, including news and weather, stock quotes, and flight information.

E-mail-to-go is the main reason to buy an i705 but, especially for corporate mail users, it falls well short of the standard set by BlackBerry. Fortunately, the real problems are in software and should be easily fixable. If the programs are reworked with some of that old Zen of Palm focus, the i705 could live up to its potential as a wireless communicator. ■

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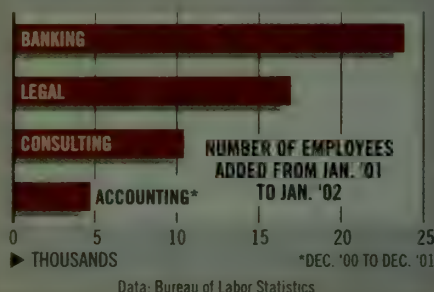
THE NEXT TO FEEL THE AX

Service industries may need to cut

With inventories almost 5% below where they were last year and employment down more than 7%, U.S. manufacturers have aggressively cut costs. That has positioned them to take advantage of any economic upturn.

Unfortunately, the same can't be said for some key high-wage service industries.

CAN HIGH-WAGE SERVICES KEEP HIRING?



tries. Anticipating a short and mild downturn, the banking, consulting, legal advice, and accounting industries have all expanded their payrolls over the past year, adding about 55,000 jobs, according to the Bureau of Labor Statistics (chart). After struggling to find qualified workers in the 1990s, "companies don't have a desire to reduce head count, because when the upturn happens they won't be prepared," says Michael F. LaPorta, global leader for insurance at Deloitte Consulting LLC.

The problem: Even if the recession ends soon, these industries may be stuck with overcapacity and falling profit margins. Banks, for example, expanded their profitable mortgage-lending operations in 2001 as falling interest rates fueled demand for home loans and refinancing. But with the Federal Reserve unlikely to cut rates again, mortgage demand should contract this year, forcing job cutbacks. Moreover, rising unemployment will boost defaults for consumer debt, hurting bank profits and increasing the pressure for cost cuts.

Similarly, excess workers remain in accounting and consulting, where employment grew at a 6.5% annual rate in the second half of the 1990s. In consulting, "all the firms have more capacity than they need," acknowledges De-

loitte's LaPorta. And accounting firms are under siege in the wake of the Enron Corp. debacle, so consolidation and job cuts are likely.

Because these industries tend to employ high-wage workers, such cuts could have a large economic impact. Taken together, banking, consulting, legal services, and accounting make up almost 7% of total private U.S. payroll outlays. As a result, widespread layoffs in these services could hurt consumer spending and counteract the gains from an expansion in manufacturing.

To be sure, some large service industries are thriving. Health-care revenues and employment, which showed a 299,000 gain over the past year, will continue to grow as an aging American population spends more on medical care. But that still may not be enough to counteract the drag from the high-wage services.

By Margaret Popper

THIS ECONOMY IS NO CHARADE

An economist dispels fraud fears

Has fraudulent accounting drastically overstated the profitability of the U.S. corporate sector in recent years—and thus the health of the economy? No it hasn't, says Steven Wieting, a senior economist at Citigroup's Salomon Smith Barney unit in New York.

Wieting says he investigated the question after receiving inquiries—particularly from foreign investors—in the wake of the Enron accounting scandal. Contrary to investors' fears, he says analysts are on solid ground in using the operating income of the Standard & Poor's 500 companies as a measure of corporate profitability. He says the measure has risen and fallen in the same pattern as the overall economy going back at least as far as 1970. The more conservative measure of profits—net income under generally accepted accounting principles (GAAP)—is actually a less effective indicator because it's affected so much by one-time events such as write-offs, Wieting says.

For instance, manufacturing production fell a sharp 7% last year. From past downturns, that should mean a 20% decrease in corporate profits—and that's just how much S&P operating income did fall. In contrast, net income under GAAP fell 50% because of write-offs, exaggerating the economic weakness. The distortion of GAAP is likely to be worse in 2002, with write-offs possibly wiping

out the entire net income of the 500, Wieting predicts.

As for the accuracy of debt measurements, the Federal Reserve has numbers on data from lenders than borrowers, so it's not mislabeled companies' attempts to hide debt balance sheet, as Enron Corp. did, even if a company manages to offload its responsibility for repaying a debt, it can't make the debt disappear from the overall economy's ledger.

By Peter

DO HOUSING SUBSIDIES WORK?

Rent vouchers are most effective

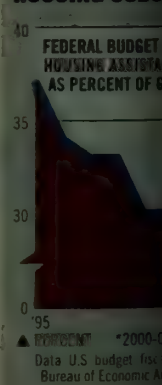
With home prices continuing to rise, affordable housing for low-income families is a pressing need. Yet subsidies have shrunk as a percentage of the economy in recent years. Critics argued that government-funded, low-income housing only replaces units that private landlords would have created otherwise (chart).

A study of the impact of housing subsidies from 1977 to 1996, including government-issued rent vouchers, public construction of new buildings, and other programs, provides ammunition for both opponents and supporters. The authors, Todd Sinai and Joel Waldfogel of the Wharton School, find that subsidies, while reducing the total low-income housing stock, also increase the total low-income housing stock. The authors calculate that government funding to build three new low-income housing units replaces two private units, on average. This adds one more unit, on net, to the total low-income housing stock. Building 30,000 new low-income units would provide new dwellings for 10,000 low-income families, or less crowding for people who already have homes.

The authors also find that giving poor people housing vouchers seems, on net, to create more places to live than directly funding the construction of public housing. The reason may be that vouchers are more likely to reach the poorest part of the population.

By Margaret Popper

LESS HELP FOR HOUSING SUBSIDIES



You're this close to seeing
the best golfers in the world.

Watch the Accenture Match Play Championship,
February 20-24 on ESPN and ABC.



BY LAURA D'ANDREA TYSON

THIS YEAR'S BUDGET BATTLE COULD BE BLOODY



PARTISAN:
With the long-term outlook worsening, the debate will highlight stark differences in how the parties would attack problems

It's budget season in Washington, and this year's political debate is likely to be especially partisan. It is, after all, an election year, and voter interest is shifting from the war on terrorism to the economy. Since September 11, Democrats and Republicans have cooperated in their support of the President's campaign against terror, but they have clashed over economic policy. And as the long-term budget outlook for the federal government has worsened, so have the prospects for bipartisanship. The political and economic stakes are high. Fundamental economic issues will be at the core of this year's budget debates, and the differences between the parties are large and significant.

According to recent numbers from the non-partisan Congressional Budget Office (CBO), during the past year the 10-year surplus for the federal government declined by an astonishing \$4 trillion. A year ago, both parties vowed to use Social Security surpluses only for Social Security. Now these surpluses must be used to cover deficits in the rest of the federal budget for the next 10 years. A year ago, the CBO predicted the government would pay off the entire federal debt within 10 years. Now the federal debt is slated to climb by \$4.2 trillion, requiring an additional \$1 trillion in interest payments.

Moreover, these projections are optimistic. They do not include the President's request for an additional \$48 billion for the military and homeland security. They do not include a prescription drug program for Medicare, promised by both the President and Congress and a high priority for voters. They do not include funds to cover either the extension of expiring tax credits or relief from the individual alternative minimum tax that threatens to engulf millions of middle-income taxpayers over the next 10 years. And they rest on the smoke-and-mirrors premise that all of the Bush tax cuts will be rescinded in 2010. A more realistic set of assumptions would show that the 10-year budget surplus has already vanished.

What are the policy implications of this remarkable reversal in the nation's fiscal well-being? First, any stimulus package to ensure the economy's recovery over the next 12 months must be small, temporary, and targeted. According to another recent CBO report, the Republican proposals championed by President Bush fail on all counts. The centerpiece of these proposals—accelerating the reduction in marginal income tax rates, scheduled to take effect between 2004 and 2006—would cost \$54 billion.

Only one-quarter of the resulting tax relief occur in 2002, however, and all of it would go to the top 30% of income-earners, who are less likely than middle- and low-income earners to boost spending in response to lower taxes.

In contrast, the Democratic stimulus package recently proposed by Senator Tom Daschle (S.D.) is limited to temporary measures, including a tax rebate for low-income families, an extension of unemployment benefits, and an expanded credit for depreciation on new investments. These measures would boost demand this year without deepening the long-run budget deficit.

The disappearance of the 10-year budget surplus means that the Democrats should challenge the Administration to provide not just a year but also a long-term budget plan. Congress and the American people have the right to know how President Bush proposes to restore fiscal discipline while enacting his tax cuts, boosting spending on the military, and meeting commitments to a growing number of retirees.

The President might try to deflect Democratic calls for a long-term budget reckoning by emphasizing the huge uncertainties that surround long-run budget projections. He would make a valid point, but not an excuse for inaction. Federal Reserve Chairman Alan Greenspan testified in his recent congressional testimony that, given these uncertainties, the Administration and Congress should devise budgetary rules that make tax cuts and spending contingent on the realization of specified targets for the budget surplus and the federal debt. Greenspan offered the same advice in last year's testimony, but it fell on deaf ears.

A heated partisan battle over budgetary priorities will shed light on the fundamental differences between Democrats and Republicans. Some of these differences revolve around the role of government. Should Social Security be privatized? Should Medicare offer a prescription drug benefit for all of the elderly, or will it credit to purchase private drug coverage? And some of these differences revolve around fairness. Should payroll taxes paid by low- and middle-income Americans be used to finance scheduled tax cuts for the wealthiest Americans who receive as much in total income as the remaining 80%? Finally, these differences revolve around whether the federal government should pay for its promises or rely on deficit spending with detrimental effects on long-term interest rates and economic growth. These are political debates worth having in an election year.

Laura D'Andrea Tyson is dean of London Business School.

AMES C. COOPER & KATHLEEN MADIGAN

PRODUCTIVITY: GALLOPING TO THE RESCUE ONCE AGAIN

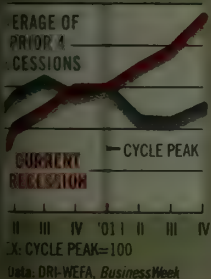
phenomenal gains will propel a recovery in profits

U.S. ECONOMY

The mess at Enron Corp. has forced investors to put the economic outlook under the microscope. Shareholders are worried that the disease of shady accounting may have tainted their own portfolios. As of Feb. 6, the Dow Jones industrial average was down some 550 points from early January, and the broader indexes are off 7% or more.

The profit outlook, however, may not be as bad as the huge sell-off on Wall Street would indicate. After the Milquetoast of postwar recessions is showing every sign of yielding to recovery. The latest data show that the labor markets are at least stabilizing, as the long-beleaguered manufacturing sector, and consumers are still hanging in there.

PRODUCTIVITY DEVIATES FROM PAST BEHAVIOR



The economic outlook in 2002 will be productivity. And right now, productivity is on track to post some very impressive gains this year.

SE ADVANCES WILL BUILD

on productivity's phenomenal performance in this recession (chart). Measured as output per hour worked at nonfarm business, productivity in the fourth quarter of last year rose at an annual rate of 3.5% from the third quarter, bringing its annualized growth rate during the past three quarters to 2.3%. For a recession, that's startling, especially since the average showing during all recessions of the past 50 years has been -0.6%. The 2001 recession was the first in postwar history in which productivity grew in every quarter of the downturn.

Last quarter's productivity surge more than offset the 2.3% quarterly rise in compensation. Note that this measure of compensation, which includes stock options, has slowed sharply in the past year from a rate of 8.9% a year ago, most likely reflecting the drop-off in realized capital gains from such options.

As a result, unit labor costs—the compensation required to produce one unit of output—dropped 1.1% last quarter, the first quarterly decline in two years. That implies profit margins, as accounted by the Commerce Dept., stabilized last quarter. The growth in unit costs slowed in every quarter of 2001. In a business climate devoid of pricing power, that means companies have acted aggressively to stem the slide in their profit margins. For this year, the combination of strong productivity growth and further slowing in compensation will continue to lift margins out of their six-quarter slump.

In fact, 2002 will mark a swing in the pendulum away from household incomes and toward corporate profits. Companies will use the increased flexibility of labor markets to their advantage. That edge is evident in the ongoing shrinkage of variable pay and bonuses, along with the layoffs in temps and other contingent workers. These trends are the opposite of the late 1990s' experience when a surging economy tightened job markets. That boosted workers' pay above even the solid gains in productivity. Consequently, costs rose, and profits were squeezed.

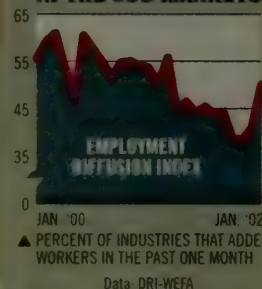
But this year productivity gains may well outpace the increases in compensation, resulting in a further decline in unit costs. That's not only due to the variable-pay factor but also because productivity always accelerates in the early stages of a recovery. Businesses are slow to rehire workers when demand first turns around. Instead, they extract more output from existing employees and lengthen work hours to fill orders. That effect will probably be greater in this recovery as businesses try to keep costs down in order to boost profits.

BUT WHILE JOB GROWTH

won't come roaring back anytime soon, the January employment report offered some signs that the worst is over in the labor markets. Private-sector payrolls fell by 84,000, the smallest decline since May. Also, the Labor Dept.'s index of the breadth of job gains rose to 50.1%, the highest since March (chart). That reading means that as many companies added to their payrolls as cut them, suggesting a broad firming in labor-market conditions.

Once again, manufacturing accounted for all of last

A JANUARY TURN IN THE JOB MARKETS



month's job losses, shedding 89,000 workers. Still, the factory sector is on the mend. Overtime hours rose for the second month in a row, and the purchasing managers' index from the Institute for Supply Management increased to 49.9% in January, the highest reading in 1½ years. That reading is effectively on the 50% mark, which means activity in manufacturing is neither rising nor falling. And rising factory orders continue to show signs of future strength.

But one apparent sign of labor-market improvement—the January drop in the unemployment rate to 5.6%, from 5.8% in December—is misleading. It mainly reflects the vagaries of Labor's seasonal-adjustment process, which caused one of the largest monthly declines in the workforce on record. Many businesses, especially retailers, did not add as many workers in December as they usually do, and so they didn't have as many to lay off in January.

For example, the jobless rate in retail and wholesale trade plunged from 7.1% to 6.3%, and the rate for part-time workers fell from 5.6% to 5.2%. Look for the direction to reverse in February and for the unemployment rate to jump back up.

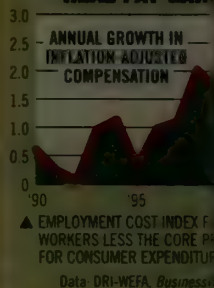
THE JOBLESS RATE is likely to climb higher this year as cost controls limit job growth. They are already affecting wage gains. Yearly growth in hourly pay of production workers has slowed from a peak of 4.4% last

September to 4% in January. Labor's broader employment cost index, which covers all workers and includes both wages and benefits but not stock options, slowed similarly, to 4.1% in the fourth quarter.

The big plus for households, though, is that real wages last year, even after removing the plus from cheaper energy, rose at the second-fastest pace since the 1960s. The fastest showing was in 2000 (chart). Credit productivity gains for this rise in household purchasing power even though nominal pay growth is slowing. Companies can lift compensation in line with strong productivity growth without putting pressure on unit costs. And inflation may even drift lower. That's why real pay gains will undoubtedly post another good increase this year.

To be sure, consumers have neither the financial nor pent-up demand to lead the recovery with the vigor of past upturns. But the point here is that a period of productivity growth is about as close to a free lunch in economics as you can get. Both wages and profits will grow this year without pushing up inflation. And corporate America's return to profitability need not be solely on the backs of the U.S. workforce.

WORKERS ARE ENJOYING REAL PAY GAINS



FRANCE

THE SLUGGISH ECONOMY WILL HAMPER JOSPIN

Like many government officials around the globe, Prime Minister Lionel Jospin of France is grappling with the repercussions of a sagging economy. What will complicate Jospin's actions is the presidential election set for May.

France's economy probably did not grow in the fourth quarter after rising 0.5% in the third. For the year, real gross domestic product likely rose 2%, the slowest pace since 1997. Consumer demand has held up remarkably well, thanks to tax cuts and lower inflation. But capital investment and exports have been hurt by the global recession.

For 2002, the government is forecasting growth of 2.25% to

2.5%, but private forecasters see a gain of only 1.3%. Recent data support the more cautious outlook. In January, industrial activity weakened further, say French purchasing managers. And consumer confidence last

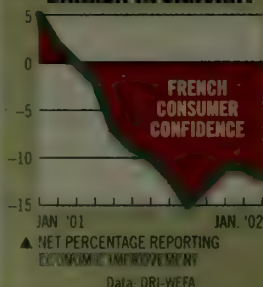
month fell for the first time in four months (chart) as consumers worried about weakening labor markets. Although the jobless rate stayed at 9% in December, it has been climbing since the spring. And the number of unemployed rose to 2.4 million in December, the highest level in almost five years.

The weak economy could hamper Jospin's possible move to bolster his Socialist Party's power by

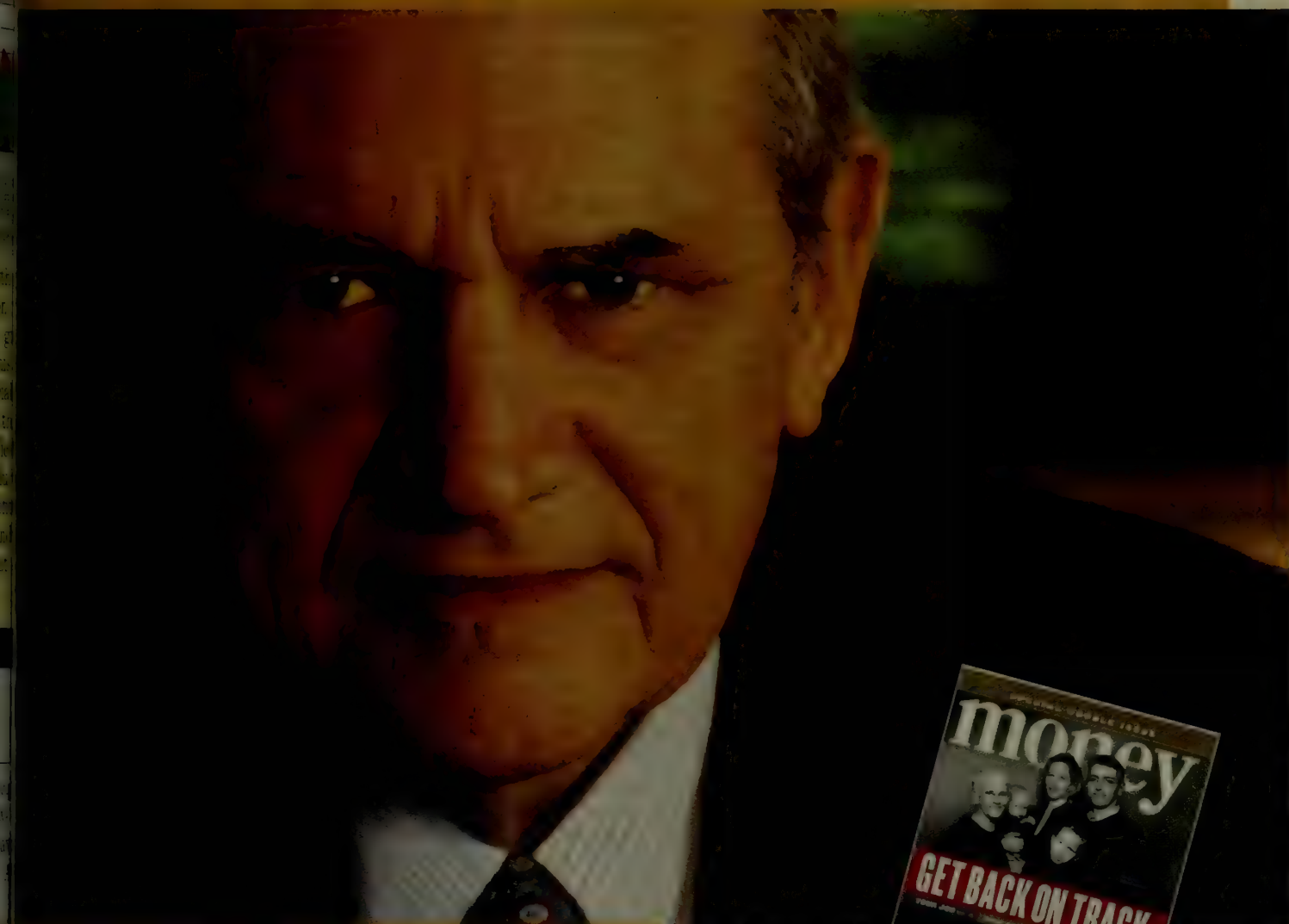
running against President Jacques Chirac in May. First, the slowdown—on top of last year's tax cuts—has trimmed revenues. As a result, the 2001 government deficit probably totaled 1.4% of GDP. For 2002, economists expect the deficit to hit 2.1% as increased welfare spending boosts public expenditures. The rising fiscal ink will make it difficult for Jospin to campaign on the promise of tax cuts.

Second, the government is being blamed for the rise in unemployment. A survey by polling firm BVA showed that 57% of French voters describe government economic policies as "bad," the highest reading in more than a year. Clearly, if Jospin wishes to unseat Chirac, he will have to turn voter sentiment—and job prospects—around quickly. ■

CONSUMER SPIRITS DARKEN IN JANUARY



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A NEW CREDIT CRUNCH

Fears about shaky accounting have all sources of credit pulling back

When the economy was last struggling to come out of a recession more than a decade ago, it was held back by what Federal Reserve Chairman Alan Greenspan described as financial headwinds. Banks, smarting from a string of loan losses from a commercial real estate boom gone bust, curtailed credit to all but the most worthy. Rather than roaring out of the recession, the economy was forced to fight its way through a credit crunch into a tepid recovery.

Sound familiar? The implosion of Enron Corp. in a mushroom cloud of scandal has profoundly rocked Americans' perceptions of financial markets, accounting practices, and corporate ethics. And it has led to a fundamental reassessment of risk throughout the economy as investors, banks, and rating agencies grapple with the realization that profit statements may not be what they seem. All that heightened doubt is leading in one direction: costlier credit that will put a crimp in corporate spending plans and act as drag on growth just as the recovery is getting under way.

For the Federal Reserve, that means holding off on raising interest rates as it struggles to rev up the economy. For banks, it means bracing for another hit to profits. Bank earnings are expected to fall 10% in 2002 as bad loans eat into

profits. And for companies, it means treacherous waters in which any hint of trouble could threaten to capsize the ship. The latest: Shares of Computer Associates International in Islandia, N.Y., tumbled 13.5% on Feb. 6, after Moody's Investors Service said it might downgrade the software maker's credit rating because of ebbing cash flow.

Worried that other Enrons are lurking in the shadows and stunned by the meltdown of such high-profile companies as Kmart Corp. Investors are treading cautiously. They're selling shares of former highfliers that use accounting gimmicks they don't understand and even questioning such blue-chip stars as General Electric Co. (page 34). And they're demanding that many companies pay top dollar for access to debt markets, in some cases forcing companies to turn to banks for even

more costly cash. A prime example: Tyco International Ltd. and its finance arm, CIT, which in early February had to tap up to \$14.4 billion in

credit lines from its banks after being shut out of the commercial-paper market (page 35).

But banks are getting stingier, too. Stung by the demise of Enron and other high-profile bankruptcies, they're tightening lending terms and cutting off companies that don't pass muster. "Banks are nervous, investors are nervous, everyone's nervous," says Howard E. Janzen, CEO of embattled telecom Williams Communications Group Inc. in Tulsa, which is in heated loan negotiations with its banks.

Throughout the boom of the 1990s, banks stretched lending to the limit, extend-

BEYOND ENRON



ush to companies and consumers at a rapid pace. Now, this aggressive lending is coming home to roost. Bad loans at big commercial banks have risen nearly 30%, to more than \$25 billion, according to the Federal Deposit Insurance Corp. Throughout the fourth quarter of 2001, lenders warned that they were slashing their earnings estimates to write off bad loans and take losses against bad debt through 2002. Meet Boston Financial Corp., the cost of \$1.2 billion. J.P. Morgan Chase & Co. chopped off \$807 million. PNC Financial Services Group Inc. knocked off \$1 billion—then subtracted \$155 million more after the Securities & Exchange Commission advised it to change accounting. In the first half of 2002, commercial loans are expected to rise 20%, says Salomon Smith Barney. That may not be the worst of it. There's also the credit banks have extended that isn't on balance sheets—and for which they have no reserves. Banks have nearly tripled their off-balance-sheet credit lines since the last recession, to about \$5 trillion outstanding, notes Prudential Securities Inc. analyst Michael Mayo. Banks tack these lines of credit into a loan to sweeten the terms of the deal. Generally, they're unused until a company gets in trouble.

As if that weren't enough, banks have heartily embraced another off-balance-sheet risk in the past decade that analysts say is nearly impossible to quantify. "Credit derivatives" act as insurance for a company that invests in a corporate bond or loan. If the debt goes bad, the company that issued the derivative pays the debtholder. Banks, including J.P. Morgan Chase, Citigroup, and Bank of America are the major issuers of derivatives in the \$1 trillion market.

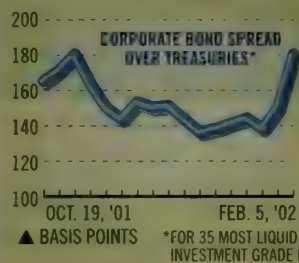
But don't expect to find their exposure on the balance sheet. Credit-derivative activity is generally listed in the footnotes, if at all. The downside can be brutal. J.P. Morgan Chase surprised markets when it said in mid-December that its unsecured exposure to Enron was triple original estimates, in part because of credit derivatives.

When you add it all up, the outlook could be grim for banks and their borrowers. Expect banks to play cleanup well into 2002. That means many will opt to lend less. Says the head of commercial lending at a top five bank:

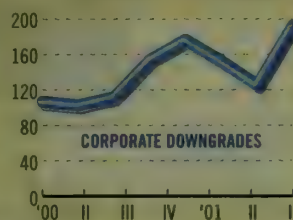
ket in recent weeks as nervous investors cut their exposure to risky companies with questionable accounting. The junk-bond market has been smacked hard, but many higher-rated companies have been hit, too. According to Morgan Stanley Dean Witter & Co., on average, borrowing costs for the 35 most active investment-grade corporate borrowers jumped by over a quarter percentage point in early February.

Credit-rating agencies are also doing their part to raise the cost of credit throughout the economy. Even before the collapse of Enron, they were ag-

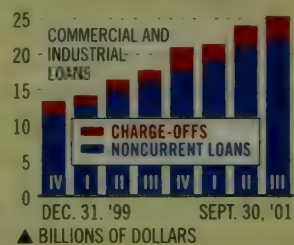
BORROWING GETS PRICIER...



...AS CREDIT QUALITY DETERIORATES...



...AND TROUBLED LOANS SURGE



Data: Morgan Stanley, Moody's Investors Service, FDIC

"You're going to see banks get tougher on terms, loans, and prices." Most affected will be corporate borrowers that rely on the same sort of aggressive accounting that Enron did—financial engineering, a steady stream of acquisitions, or off-balance-sheet entities to make their numbers. But even conservative companies could be hurt. "We're concerned that the general credit market will tighten up more," says Bruce W. Smith, CFO of Atlanta-based biotech Theragenics Corp. "Enron is just putting further pressure on large banks that already feel under the gun."

Enron's demise has sent shock waves throughout the financial markets as well. The multibillion-dollar commercial-paper market that companies use to raise short-term money had already shrunk by a third last year as investors simply refused to finance many firms deemed too risky. Now, in the wake of Enron's collapse and growing doubts about corporate accounting, many companies still in the market are finding they're having to pay more to issue commercial paper. In some cases, they're paying up to a quarter percentage point extra.

Enronitis has also sent borrowing costs higher in the corporate-bond mar-

gressively slashing corporate credit ratings as the economy deteriorated. Downgrades soared to record levels in the fourth quarter of last year, raising corporate borrowing costs.

Now, ratings agencies have ratcheted up their oversight even further. "We've accelerated and heightened our credit-review process," says Edward Z. Emmer, executive managing director of Standard & Poor's, which, like *BusinessWeek*, is owned by The McGraw-Hill Companies. S&P is spending more time looking over company accounts and broadening its review to include customers and competitors. In the wake of Enron, ratings agencies are also paying more attention to equity and corporate bond prices as early warning signs that a company may be in trouble.

This wide rethinking of risk probably won't send the economy back into recession. But the post-Enron environment will temper growth and delay the onset of a full-fledged expansion. Just tack it on to the growing list of misgrains that Enron has wrought.

By Rich Miller in Washington and Heather Timmons in New York, with Andrew Park in Dallas, Charles Hadad in Atlanta, and bureau reports

FINANCING

GE: MORE DISCLOSURE, PLEASE

Investors eye GE Capital's numbers in the wake of Enron

For years, the hottest product at General Electric Co. hasn't been lightbulbs or even aircraft engines. It has been money. From extending almost \$2.5 billion to Xerox for equipment financing to getting an \$84 million bout of indigestion from Enron Corp. bonds, GE Capital seems to have a finger in almost every corporate pie. It has even dabbled in such oddball pursuits as car auctions and pet insurance. Many think its next target could be CIT, the financial arm of troubled Tyco International Ltd. "We are portfolio managers driving toward double-digit growth," says GE Capital Corp. Chairman and CEO Denis J. Nayden. "We're also very efficient acquirers."

Indeed. Investors credit this business-gobbling behemoth with helping its parent deliver remarkably consistent double-digit earnings growth. What began in the Great Depression as a credit operation to finance refrigerators has become a financial-services giant with 25 global businesses. It boasts more than \$425 billion in assets and accounted for 40% of GE's \$14.1 billion in earnings in 2001.

But in the wake of Enron's collapse, investors are increasingly unnerved by how tough it is to decipher GE Capital's opaque finances and the impact of its voracious acquisitions drive. Since Jan. 1, the confusion has helped send shares down almost 15%, to \$35, though GE Chairman Jeffrey R. Immelt managed to stop the slide on Feb. 5 when he reconfirmed that GE would hit its 17%-to-18% earnings-growth target in 2002. "GE isn't a faith stock," Immelt insists. "It's a performance stock."

Perhaps. But critics say there's little in the way of specific numbers to back that up. Currently, the unit doesn't break out the performance of its businesses, which range from credit cards to insurance to the leasing of everything from jets to trucks. Instead, they are consolidated into five categories, so details such as loan reserves and losses are anyone's guess. And like its rivals, GE Capital often



AIRBORNE: CEO Nayden's unit accounted for 40% of GE's earnings in 2001

doesn't give information on the size of its acquisitions or what it paid for them.

Investors also complain that much of the information the unit does release isn't timely since it comes out in the annual report. And because it's not a bank, operations are not subject to the same level of regulation

as other financial institutions. Investors say they can't even tell if it's true that only 3% of GE Capital's business comes from financing sales of GE's industrial products, as the company claims. "Disclosure is substandard," says Brian James of shareholder Loomis, Sayles & Co.

True, Immelt releases more numbers than his predecessor, Jack Welch. He does Webcasts and offers more details on individual units. "We're trying to be more accessible and clear," says CFO Keith S. Sherin.

But GE Capital could do a lot more. Its revenue and profit growth have vastly outstripped its industrial business over the past decade. Nayden says its earnings growth comes from one-third acquisitions, one-third internal growth, and one-third productivity gains. But investors contend that it's hard to confirm those numbers. Many also wonder how a huge collection of work-

day finance businesses can continue to get double-digit earnings growth out of an undue reliance on acquisitions. Most comparable rivals, such as Citigroup, report rates of just 4%.

Even basic measures of return are open to debate. The company says Capital's return on equity is about 24%. But analysts such as Robert F. Iman of Standard & Poor's favor adjusting for the unit's high debt-to-equity ratio. Iman estimates that GE overall generates a return on equity of just 9%, vs.

the company's debt-included figure of 27%. GE points out that its debt is comparable with other financial services companies and factored into the AAA credit rating.

Still, investors say they can't judge health for themselves. "GE has more credit than anybody else," Iman has to disclose more to avoid being lumped with companies that don't," says Rob Platten of Morningstar Inc. Gary Wendt, who led the finance unit from 1998, says that "what Capital does isn't rocket science." If that's true, shouldn't take a rocket scientist to figure out the books.

By Diane Brackley
New

BEYOND ENRON

The Two Faces of GE

General Electric's financing unit, GE Capital, has driven the company's revenue and profit growth. Still, its margins are lower than the industrial division

AVERAGE GROWTH RATE 1991-2001*

REVENUES

INDUSTRIAL 4.7%

CAPITAL 13.5

OPERATING PROFITS*

INDUSTRIAL 9.1

CAPITAL 12.0

ANNUAL AVERAGE 1991-2001

OPERATING MARGINS**

INDUSTRIAL 15.8

CAPITAL 10.3

*Compounded annually

**Excludes pension gains

Data: Standard & Poor's
Equity Group

TYCO LOOKING A FIRE SALE?

conglomerate is scrambling to raise cash to pay its debts

The elite world of yacht racing, Tyco International CEO L. Dennis Kozlowski is known for his ability to navigate rough seas. But the captain of America's most ambitious conglomerate has never faced force winds like these. Two weeks after he unveiled a surprise plan to

split Tyco into four midsize companies and bondholders alike jumping ship in sheer panic. The move was sparked by fears of an impending cash crunch, after Tyco and its arm, CIT, announced they would sell all their \$13 billion in commercial paper for more expensive bank debt. Both have been effectively shut out of the commercial market—leaving even big fund managers saying they would shoot first and ask questions later, says an analyst at one institutional holder.

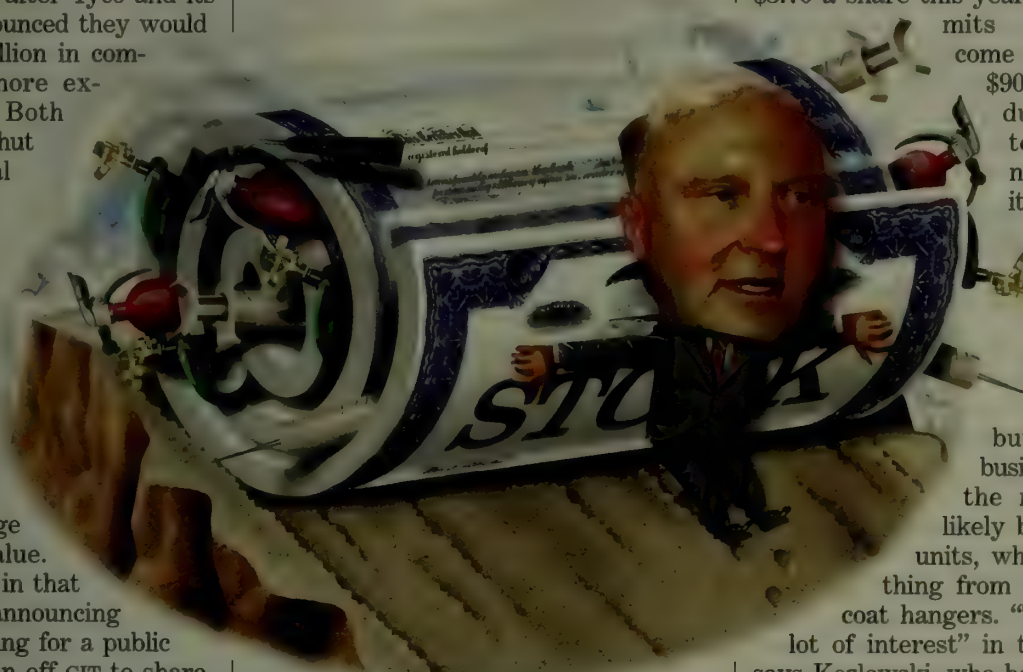
The question is whether Kozlowski can regain enough time to salvage the underlying value. It took a small step in that direction on Feb. 6, announcing rather than waiting for a public offering, Tyco will spin off CIT to shareholders within 8 to 12 weeks. And it could move even sooner if it gets a better offer from one of its potential bidders, General Electric Co. That news sent the stock \$2.83, to \$25.93—finishing a slide that sent shares from \$59 on Dec. 31. Fears about Tyco's opaque accounting had branded it the next Enron," vaporizing more than \$60 billion in market value.

A successful spin-off or sale of CIT is expected to head off a potential cash crisis at Tyco's finance arm. The company has \$12.5 billion in commercial paper and other debt obligations coming due through June. CIT says that because of an \$8.5 billion bank line it tapped about \$5 billion more in securitization facilities, it is covered for five months. But the company, which was the largest independent commercial-outfit before Tyco bought it, has

enormous financing needs. "There is less confidence in us, and that poses terrific issues," says CIT CEO Al Gamper Jr.

Even without CIT, Kozlowski still must deal with a mountain of debt left over from the \$63 billion acquisition binge he has indulged in since 1995. As of Dec. 31, Tyco's industrial companies had \$28.3 billion in debt, according to Standard & Poor's, up from just \$20 billion last March. The swap to bank credit should cover Tyco's debt obliga-

BEYOND ENRON



tions for the next year. But combined with CIT's similar move, it also will cut earnings up to \$300 million this year, due to higher interest costs, Kozlowski admits. Worse, it signals that the debt clock is ticking. "They have diminished financial flexibility," even as they have more than \$9 billion of debt still coming due next year, says Cynthia M. Werneth, an analyst at S&P, which cut Tyco's debt rating three notches, to BBB, on Feb. 4.

Kozlowski has long argued that he has plenty of cash coming in to meet Tyco's ongoing financial needs. "There is a crisis of confidence, but there is no cash crisis,"

he insisted in the Feb. 6 conference call. But Tyco likes to use an unusually generous definition of cash flow. In the fiscal year ended Sept. 30, it reported \$4.75 billion in "free cash flow." But that didn't count more than \$2 billion it spent to build the massive Tycom undersea global-telecom network. Subtract that, and Tyco had just \$2.5 billion in cash flow, figures S&P's Werneth. Nor did it count some \$900 million spent on "purchase accounting liabilities," or acquisition-related costs such as layoffs. Subtract those, and free cash drops to just \$1.6 billion, argues Albert J. Meyer, an analyst at David W. Tice & Associates Inc., a frequent critic of Tyco's accounting.

Meyer is equally skeptical of Kozlowski's claim that Tyco will generate \$4 billion in cash flow this year. Kozlowski brandished the same number a month ago, while predicting Tyco would earn \$3.70 a share this year. Yet now he ad-

mits earnings could come in 45¢—or some \$900 million—lower, due to higher interest costs and new weakness in its depressed electronics unit.

With Tyco unable to tap equity or debt markets, Kozlowski has little choice but to sell off his businesses. After CIT, the next to go will likely be Tyco's plastics units, which make everything from garbage bags to coat hangers. "There's an awful lot of interest" in those businesses,

says Kozlowski, who hopes to announce a deal by spring. Problem is, Tyco is in no position to run an orderly auction. And given the bull-market prices it paid for many acquisitions, it could book losses on many of the sales. That's particularly true of CIT, for which it paid \$10 billion last June, warns Barry B. Bannister, a Legg Mason Inc. analyst. Another investment banker

says Tyco "won't come close" to fetching the \$3 billion Kozlowski wants for plastics. "We think it's more likely a fire sale" will occur now, he adds. Tyco is adrift in a steadily pounding sea, with little letup in sight.

By William C. Symonds in Boston, with Emily Thornton in New York

THINGS AIN'T WHAT THEY USED TO BE

Value of Tyco's Acquisitions,
1996-2002

\$63.6 billion

Market Value of Tyco Today

\$51.7 billion

Data: Thomson Financial Securities Data Corp., Bloomberg Financial Markets

the letter of the law, he
torts to delve deeper into
and dig out their true rami-
Who really controls the SPE?
liabilities come back to the
attempting to get them off the
o, they should be consolidat-
ter how much outsiders own.

things that matter

ronouncements by the SEC
ave attempted to clarify
its and data are important
be considered "material."
nother area where simple
provided too much wiggle
thing less than 5% or 10% of
or assets was generally con-
d "immaterial" to overall per-
e and thus could be left
f the statements. But recent-
e SEC made it clear that the
e must be addressed "qualita-
ly as well as quantitatively,"
s Bear, Stearns & Co. ac-
counting expert Pat McConnell.
et on Feb. 4, many were
zed by revelations that indus-
conglomerate Tyco had made
reds of acquisitions totaling
lion over the past three
Because each purchase was
small, its impact was consid-
nmaterial. Tyco did disclose
gregate spent on the deals
not detail them. "Any one
on, if you looked at it in iso-
ight not be material, but
need to look at is the entire
ction," says Lehman Broth-
counting guru Robert Wil-
ors should demand that com-
ort even the smallest
if it is important.

List the risks and assumptions built into the numbers

■ This is something SEC Chairman Pitt has been hot to do. Pitt wants disclosure of the "three, four, or five" critical accounting principles at every company. Although they may involve ambiguity and judgment, the principles are vital

If financial statements aren't made more credible, there is little hope of restoring investor confidence

to a company's financial status. So far, Pitt hasn't provided much detail on how businesses would accomplish this goal. As the Enron scandal showed, corporate guesstimates can play a big part in corporate earnings: Managers there estimated what the future demand for their products would be and derived current earnings based on those guesses. This is one step beyond "mark to market" accounting, whereby financial instruments are valued based on current worth. David F. Hawkins, a Harvard Business School professor and Merrill Lynch & Co. accounting consultant, calls it "mark to model" and says it's "a big black box for investors right now." He would like to see more information about the assumptions inherent in these calculations in a footnote to the financials.

Standardize operating income

■ The mushrooming of so-called pro for-

ma operating earnings, calculated according to each company's whim, was an issue even before Enron's collapse. To get more uniformity, Standard & Poor's has put out a proposal for what should be included and excluded in these operating-earnings calculations. Last fall, FASB put the topic on its agenda, although very little progress has been made to date. Setting up a universal formula is just the first step, though. Companies also must provide enough detail to show what they added and subtracted from GAAP net income to get to their pro formas.

Provide aid in figuring free-cash flow

■ To many investors, this is the real bottom line. How much cash, net of interest, and other obligations will a company generate in the future? Today, analysts make this calculation themselves, largely by extrapolating from past results. But some are now calling for additional information to make the calculation easier. "The real question is, how do you predict the future, and who's best able to do that?" says Ed Nusbaum, CEO of accounting firm Grant Thornton LLP. Companies currently are reticent to provide too much information about the future for fear of being sued, Nusbaum says, but investors are calling for more such data in the section of the annual report entitled "management discussion and analysis."

What investors want from financial statements is a clear picture of corporate performance. Instead, they are often left to guess at information that companies should readily provide.

With Michael Arndt in Chicago and Susan Scherreik in New York

Jan. 9: 1155.14

The Justice Dept. confirms it is investigating Enron

Jan. 28: 1133.06

Proxy shows Tyco paid \$20 million to board member and his favorite charity for work on Tyco's largest acquisition ever, the purchase of CIT

Feb. 4: 1094.44

Enron special committee report condemning accounting irregularities, together with Tyco debt refinancing, help send market down 2.5% in a day

Jan. 5: 1146.19

Enron fires its lead on the Enron account relations of extensive shredding

Jan. 22: 1119.31

Tyco begins what will eventually be a 45% drop after announcing plans to split up, renewing worries about its mergers

Feb. 6: 1083.51

COMMENTARY

By Mike McNamee

401(k)s: WORKERS NEED EDUCATION, NOT HANDCUFFS

Corporate America has a one-word response to proposals to reform 401(k) retirement plans: choice. Regulate 401(k)s to prevent a repeat of the Enron Corp. meltdown, business advocates say, and you'll take away workers' freedom. They'll admit that thousands of Enron employees are stuck with worthless stock. But no matter. "For every heartbreaking Enron story, there are 20 other modest-income people who've become rich because they invested in their company's stock," says James A. Klein, president of the American Benefits Council, which represents big companies. "We don't want that choice taken away."

That would be great if the current system were truly built around choice. Trouble is, today's 401(k) plans often subvert workers' best interests to other corporate goals, such as creating a pool of captive shareholders who'll support management and resist takeovers. If business believes what it says about employee empowerment, it will stop fighting President George W. Bush's modest 401(k) reforms. His proposal, among other things, would allow employees to sell company stock after three years and create incentives for employers to hire investment advisers for 401(k) savers. Those moves would improve workers' options.

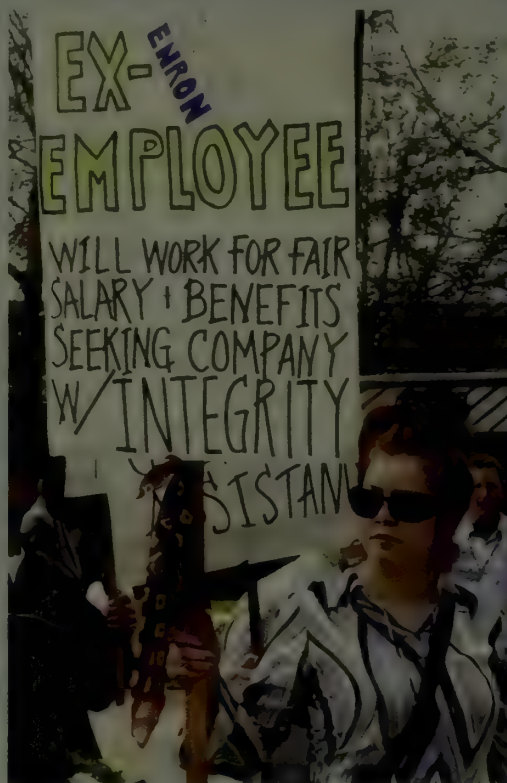
Business, though, is right to resist the Democrats' favorite 401(k) fix, caps on company stock. Limiting company stock to no more than 20% of a 401(k) account, as Senators Barbara Boxer (D-Calif.) and Jon S. Corzine (D-N.J.) propose, would be overkill at the majority of companies that match 401(k)s with company stock, because most such firms also have healthy traditional pensions. Workers should have the right to buy company stock, after all. Caps would punish workers at such companies as General Electric Co. or Microsoft Corp. whose stocks have outperformed the market.

But even successful companies have no right to twist workers' investments to meet management's needs. Take the reliance on employee

stock ownership plans, or ESOPs, to match worker 401(k) contributions. Companies establish ESOPs because they think employee-shareholders work harder, or they want a block of shares beyond raiders' reach. But those reasons have nothing to do with the goal of 401(k)s—creating retirement security. And ESOPs used as 401(k) matching grants are by definition narrow, barring workers from

says Shlomo Benartzi, behavioral finance expert at the University of California at Los Angeles. These people need education. Companies shouldn't bad-mouth their own stock. But they shouldn't be able to pile their stock, either. Instead, they should hammer home diversification.

The same holds true for independent investment advisers that companies hire to help 401(k) participants



selling stock until age 50. Congress should phase them out.

At the minority of companies that use non-ESOP shares to match 401(k)s, workers should have the same freedom to buy or sell those shares as they do any other 401(k) investment. At most, companies should be allowed

to limit company stock sales for a year, not the three-year hold Bush wants. Why? Just think what

most portfolios are worth today vs. 1999. Three years is clearly too long to freeze investment choices.

What about workers who load up on company stock with their own money? "Nine out of 10 employees believe that company stock is actually safer than a diversified mutual fund,"

HOW TO FIX THEM

- Don't let companies match 401(k) contributions with shares in an ESOP, because such shares are locked up until age 50.
- Bar companies from requiring workers to buy company stock. If a company gives stock as a match, allow employees to sell a year after vesting.
- Educational materials and plan statements should point out the risks of concentrating narrowly in company stock.
- Company-sponsored investment advisers should be required to assess an individual employee's risk of overconcentration in company stock.

Too often advisers treat company stock as untouchable. Congress should give companies more incentives to provide advisers but require advisers to analyze company stock like any other investment and issue warnings about the risks of an unhealthy concentration.

Will these measures prevent another Enron retirement disaster? In a voluntary, investor-directed system it's impossible to prevent employees from making mistakes. Many would relish the freedom and control 401(k)s give them. But freedom to vest should mean freedom to follow your best interests—not the boss's.

McNamee covers investing for Washington.

**BEYOND
ENRON**



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CORPORATE GOVERNANCE

UNLEASHING THE WATCHDOGS

Audit boards are trying to show teeth. It won't be easy

In anyone's list of culprits in the Enron bankruptcy, the board's audit committee appears near the top. Its poor performance underscores something audit committee members have known for years: They have the most difficult and hazardous job on any board. As boards struggle to reform their own audit committees in Enron's murky wake, they face a truly difficult task: making badly needed improvements to an audit-committee system that has resisted improvement in the past. And the boards need to do so without creating unintended new problems in the process.

In boardrooms and executive suites across Corporate America, Enron has prompted a fundamental rethinking of how audit panels are recruited, paid, and expected to perform. Audit committees' main task is to oversee the external audit and to monitor company finances. But over the years, many audit panels have fallen down on the job. They often sign off on hiring "independent" auditors, who, in fact, come with massive conflicts of interest, including multimillion-dollar consulting contracts with the company they're supposed to be auditing. And even the most upstanding audit panels often fail to ask the tough questions.

To address those problems, boards are considering a host of reforms. Tops on the list are more frequent meetings and more generous pay for committee members. Companies also are casting the net wider in hopes of finding topflight financial executives willing to serve as audit-committee chairmen. And they are beginning to ask directors with fi-

nancial ties to the company to step aside.

Will such changes transform these committees into corporate watchdogs with real teeth? That will be tough because the proposed reforms do little to address the problems—and they may even create new ones. Many governance consultants now suggest that the audit committee add an extra two meetings a year, for example. But that's unlikely to be enough to improve oversight significantly, especially at companies like Enron Corp. or Tyco International Ltd. with hugely complicated financials. And more frequent auditor committee meetings would do nothing to solve the biggest problem: "At some companies, external auditors feel they work for the chief financial officer," says Bruce R. Chizen, CEO of Adobe Systems Inc. "That should change."

Then there's the issue of pay. Given the increased amount of work involved, compensation experts say many compa-

nies are considering paying audit chairmen an additional \$5,000 on the \$10,000 most of them receive. However, that's hardly enough of incentive for busy, talented executives to serve. And the more audit committee members are paid, the more the increase from the inherent conflict exists when any watchdog is on company payroll.

Recruiting CFOs and former chief executives. Five accounting firms serve on the audit committee, as both Adobe Sys-

and Accenture Ltd. have done more promising approach. Who better grill auditors than someone who it for a living? Unfortunately, there only so many of these folks around. Assigning the audit committee staff of its own or making the committee's chairmanship a full-time job other alternatives that have been using currency among corporate leaders place the audit committee on a steep slope. Give the audit committee bureaucracy, a budget, a salary, and fits, and it would be virtually indistinguishable from management.

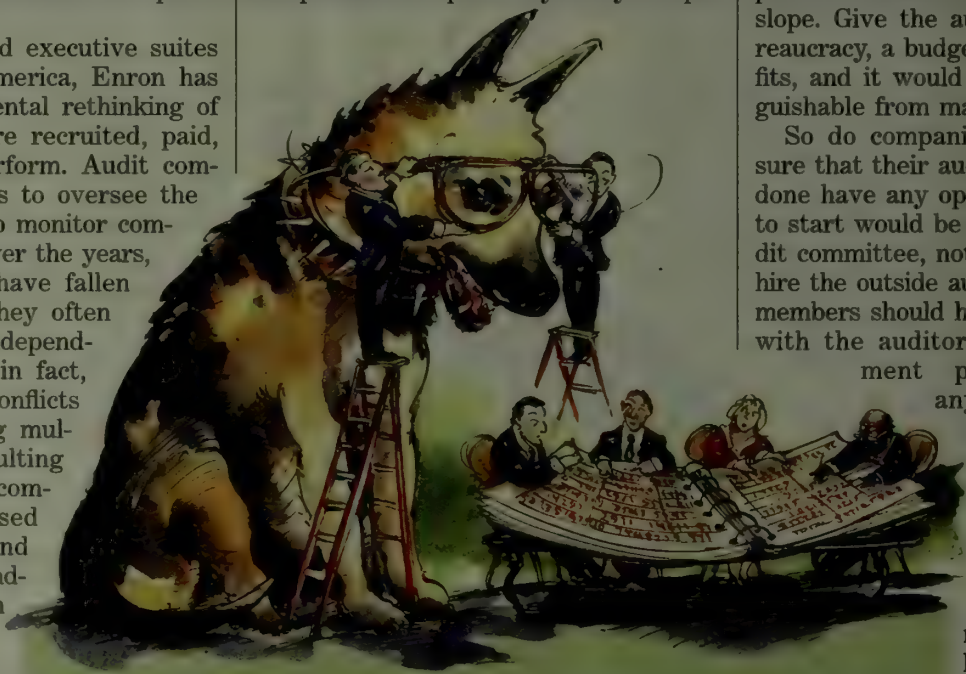
So do companies that want to ensure that their audit panels get the done have any options? The best to start would be insisting that the audit committee, not the CFO, choose hire the outside auditor. And committee members should have frequent contact with the auditors—without man-

agement present—to discuss any accounting issues that arise.

Those measures would go a way toward making it clear who's boss when it comes to auditing. Fundamentally, though, the key to building a successful audit committee lies in attracting directors who are enough about financials to ask the right questions and who are brave enough to stand up to the financial officer and the rest of management when they see something fishy. Fortunately, there are no good rules for achieving that.

By Louis Loeb
in New York

BEYOND ENRON



EYES OPEN AND A NOSE FOR TROUBLE

How boards are rethinking their audit committees

MORE MEETINGS

Worries that audit panels meet too infrequently have prompted calls for more regular meetings.

HIGHER PAY

An increasingly complex workload for committee auditors has companies considering boosting compensation.

WIDER RECRUITING

The growing demands of the job are scaring away talent. To fill vacancies, boards are seeking CFOs and other financial execs.

INDEPENDENCE

Audit panel members are now permitted to have financial ties to companies. Some critics say that should end.

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I.T. IS VITAL TO THEIR BUSINESS SO THEY'RE TRUSTING THEIR BUSINESS TO COMPAQ.

COMMENTARY

By Bruce Nussbaum

DON'T BE SO FAST TO KNOCK THE U.S. ECONOMY

Perhaps it was the laughter in the lobby of the Waldorf Astoria from a group of German businessmen that first signaled how much U.S. corporate prestige had fallen in the eyes of the world's elite. Facing two tall banners listing the World Economic Forum's strategic corporate partners, the Germans guffawed as they pointed at Andersen, Enron's auditing firm, and chuckled at Global Crossing Ltd., the broadband telecom company sinking in a sea of accounting irregularities. Where once they dominated the doings at Davos, U.S. companies were the subject of derision at this year's Davos-on-the-Hudson, held in New York.

The Nasdaq meltdown, the scandalous failure of Enron—the poster child for deregulated, asset-free companies—and the shocking comedown for high-tech execs combined to tarnish both the managers and the model of U.S. economic success. Yes, there was a certain amount of *schadenfreude*, taking pleasure in others' trouble, especially among Europeans who thought America's success in the '90s was

Sources of Vulnerability: Thinking the Unthinkable."

Worse, the American CEOs themselves were spreading pessimism about the prospects for growth in the year ahead. Where once they waxed eloquent on endless possibilities, this year they exuded worry. The techies were the worst. Nobel laureate (and *BusinessWeek* Economic Viewpoint columnist) Gary S. Becker asked whether the younger techie CEOs who hadn't been through a business cycle before might be projecting too much pessimism

the depressing patter of American CEOs was plenty of evidence for optimism. At the session "Higher Productivity: Old Myth from the New Economy?" people agreed the U.S. had, in fact, achieved major success raising productivity growth. They said it's

rising at 2% to 2½% annually, up from 1.4% a year in the '70s and '80s. That meant the U.S. economy could safely grow at about 3% a year—good news. But few heard it as they ran to the Four Seasons to down martini and worry about bioterrorism.

Also lost were the lessons from a workshop called "CEO Brainstorm: Leadership in Fragile Times." Davos participants from Europe, Asia, the Middle East, and Latin America gathered around about 20 tables. It was a stellar cast including Carlos Ghosn, president of Nissan Motor in Japan; Azim H. Premji, chairman of India's Wipro Technologies; Henning Kagermann, co-chairman of SAP; and Arthur Sulzberger Jr., publisher and chairman of *The New York Times*. Each table was given one of three global scenarios ranging from gloomy to

gloomier to gloomiest and told to write a corporate strategy to survive and prosper. The results surprised. One strategy emerged: Bet on technology, outsource, be nimble, build core capabilities, enter new markets, Web-base everything, and be sensitive to global forces. Sound familiar? These are tactics from the New Economy playbook used so well in the U.S.

My guess is there will be a bit more swagger among U.S. CEOs and more confidence in the U.S. economy when the world's elite returns to Davos and the ski slopes of Switzerland next year. Despite the anxiety, the fundamentals appear sound.

Nussbaum is Editorial Board Editor and a Davos regular.

BEYOND ENRON



PESSIMISM

Some great news on U.S. productivity emerged at the World Economic Forum, but most missed it

AOL TIME WARNER'S RICHARD PARSONS ADDRESSES THE CONFERENCE

a bubble in the first place. There was also serious unease at the Waldorf as to what truly ails Corporate America—especially from those who have sought to emulate the best of the U.S. free-market economy. Ironically, some great news on U.S. productivity emerged at the WEF, but most missed it.

It didn't help that many workshops reflected the angst of the moment: "Global Capital Markets: Stressed Out?"; "Anti-Americanism: What's New, What's Next?"; and "New

from their recent, and only, trauma. Becker thought they might be underestimating the economic recovery.

Princeton's Alan S. Blinder agreed, saying that in the past four recessions people warned there was too much capacity, too much overhang, and that it would take years to recover. Then came recoveries and it all disappeared rather quickly. He's a "V" man, by the way—predicting a strong recovery.

Lost in the fog of uncertainty about the U.S. economic model and



24-HOUR GOVERNMENT

by

HONG KONG

SOLUTION

by

COMPAQ

Compaq, in a joint venture, built an Internet portal, www.esd.gov.hk, that connects the Government of the Hong Kong Special Administrative Region with its citizens online. Now it's easy to get the services you need from almost 40 government departments and public agencies, even at 4 in the morning.

IT IS VITAL TO THEIR BUSINESS SO THEY'RE TRUSTING THEIR BUSINESS TO COMPAQ.

COMMENTARY

By Howard Gleckman

BIG SPENDING WRAPPED IN A FLAG

Remember the old days of budget surpluses? That's good, because you won't see them again for a long time: President Bush's fiscal 2003 budget could well kick off a tax-cutting and spending spree the likes of which we haven't seen since the days of Ronald Reagan. Even as Bush is proposing nearly \$2 trillion in new initiatives and tax breaks over the next decade, Congress is ready to trump his ideas with costly ideas of its own.

Bush's budget calls for a deficit for at least the next three years. After that, the budget would be back in the black, but only because he would use Social Security payroll taxes to fund other programs. "This budget will open the floodgates," says Robert Bixby, executive director of the Concord Coalition, a Washington group that backs fiscal discipline.

While the President has literally wrapped his budget in a flag cover, only about one-third of his new agenda—roughly \$650 billion—is directly related to the war on terrorism. Another third is a potpourri of other spending, including a drug benefit for seniors, a big boost in farm subsidies, and \$70 billion to subsidize the cost of health insurance. The rest represents new tax cuts. Most would make permanent Bush's 2001 tax reduction, now due to expire in 2010.

Although the Bush agenda will throw the nation back into deficit, it is unlikely to recreate the fiscal sinkhole of the 1980s. Bush's tax cuts, including last year's, are roughly the same size as Reagan's 1981 plan: a bit more than 2% of gross domestic product, according to Brookings Institution economist Peter R. Orszag.

But his war on terrorism is far less costly than other recent conflicts. When the Gipper came into office in 1981, the nation was spending 4.9% of GDP on cold war defense. Within five years, Reagan had pushed that to 6.2%. By contrast, in 2000, the nation was spending about 3% of GDP

ly keep up with inflation. And some Republicans want to cut more debt than that. They will demand a balanced budget in fiscal '03, instead of the \$80 billion deficit Bush is embracing. Says Senator Jeff Sessions (R-Ala.): "I am concerned that we will lose the high ground on containing spending."

Still, the White House doesn't seem very worried about deficits. And Democrats—along with many Republicans—have a dead mind. They will accept Bush's initiatives if he agrees to theirs. The likely result: a frenzy of spending all cloaked in the fog of war.

Conservatives worry that for all Bush's talk about smaller government, he has been a fairly enthusiastic spender. Last year, he agreed to spend more for education as the price for his signature schools bill. He has already embraced \$70 billion in new agricultural subsidies pushed by farm-state legislators. And



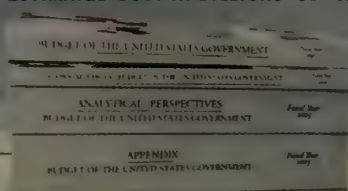
CAMOUFLAGE? Bush wants money for more than defense

despite budget director Mitch Daniels' tough talk about slashing wasteful spending, Bush would kill just a handful of programs. "Their rhetoric is refreshing," says Chris Edwards, director of fiscal policy at the libertarian Cato Institute, "but in the end, they step back. That gives the wrong message."

So does Bush's green light for a new round of tax cuts even as he proposes spending increases. Osama bin Laden may provide convenient political cover for a spend-a-thon, but the war on terrorism has not made fiscal discipline irrelevant.

Gleckman covers fiscal policy for Washington.

BUSH'S BUDGET-BUSTING INITIATIVES
ESTIMATED COST IN BILLIONS '03-'12



DEFENSE AND HOMELAND SECURITY
\$650

MAKING 2001 TAX CUTS PERMANENT
\$394

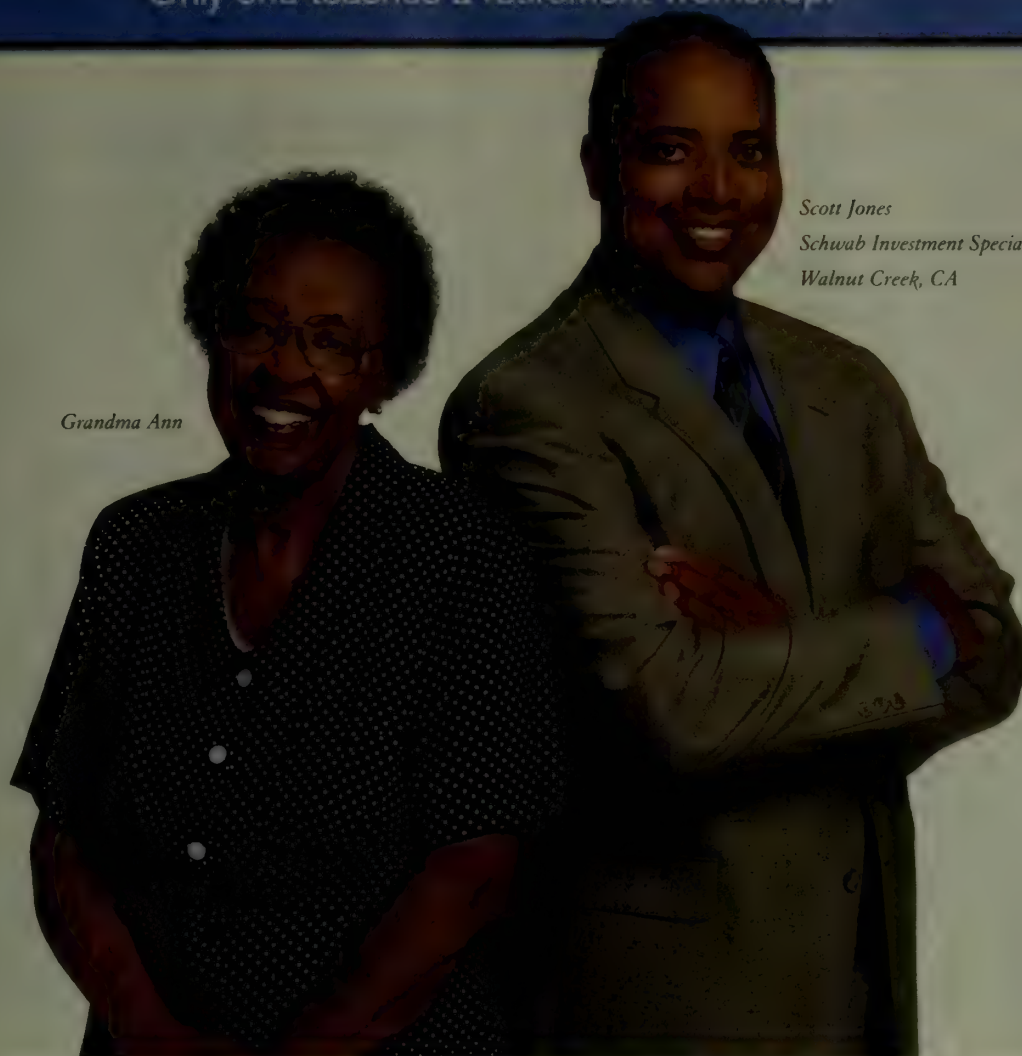
MEDICARE DRUG BENEFITS
\$190

NEW HEALTH-CARE TAX BREAKS
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NEW FARM SUBSIDIES
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Data: Office of Management & Budget

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In Business This Week

EDITED BY MONICA ROMAN

THE SEC SLAPS CRITICAL PATH

THE AFTERSHOCKS FROM ONE of the Internet's biggest accounting scandals are being felt. The Securities & Exchange Commission on Feb. 5 doled out fines and other reprimands to two former Critical Path executives who helped orchestrate fictitious transactions for the onetime Internet highflier. *BusinessWeek* first detailed Critical Path's accounting violations (BW—Aug. 6), which included back-dating of contracts and booking revenues from fictitious contracts. The SEC levied a \$110,000 fine on former President David Thatcher and banned him from serving as an officer or director in a public company for five years. Former sales exec Timothy Ganley was fined \$105,900. The two men now face criminal charges from the U.S. Attorney's Office. The SEC says that it will not fine Critical

Path but will continue to investigate other former executives.

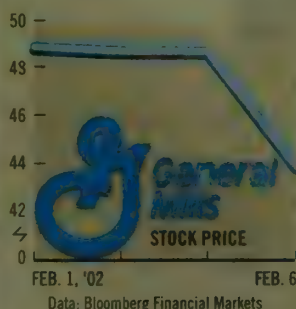
BUSH SCOLDS FANNIE AND FREDDIE

IT'S A CATCH-22 FOR FANNIE Mae and Freddie Mac, the government-sponsored entities created by Congress to assist in home financing. In response to criticism from the Housing & Urban Development Dept., the companies in recent years have reached out to low-income home buyers by financing subprime loans. But in its fiscal 2003 budget, the Bush Administration chastised Fannie and Freddie for their increasing exposure to subprime loans, which tend to be riskier than conventional mortgages. Fannie and Freddie officials say the concern is unfounded, since nearly all of their subprime loans are bought with credit guarantees from the lender.

CLOSING BELL

DOUGHBOY WOES

General Mills' stock price sank 10.59% on Feb. 6, to 43.55, after it cut earnings estimates for its third quarter ended Feb. 28 and fiscal 2002. The culprit? Trouble integrating Pillsbury—purchased in November, 2001—is leading to an estimated 3% to 4% drop in volume in the current quarter.



WIRELESS STOCKS DISCONNECT

SEVERAL WIRELESS OPERATORS in the U.S. watched their shares plummet to near lows after reporting lackluster fourth-quarter growth and indicating that their new-subscriber growth will slow down considerably during the coming months. On Feb. 5, shares of Nextel Communications tumbled 25%, while Sprint PCS lost 20% and AT&T Wireless fell 3%. Sprint, which had been signing up new customers at a sizzling pace, said on Feb. 4 that it expects 3 million new subscribers in 2002. That's down from an earlier forecast of at least 3.6 million. The number of new customers across the cellular industry sank 9% during 2001, according to Bear Stearns, and is expected to drop 11% this year to about 19 million.

HEADLINER: CARLY FIORINA

CATCHING THE BIG MO

JUST WEEKS AGO, HEWLETT-Packard's \$24 billion acquisition of Compaq Computer seemed to have no chance, given opposition from founding family stockholders and foundations. But HP CEO Carly Fiorina may now have momentum on her side. On Feb. 5, she claimed HP had "more than sufficient" votes to win. The next day, HP set the shareholder vote on the merger for Mar. 19.

What changed? HP has provided investors with a clearer picture of how the companies would fit together. And HP's Feb. 4 news that it would beat its

quarterly earnings estimates has increased investor confidence in Fiorina. Then there are Fiorina's power persuasion. "Every time I've heard her, I've heard her stronger and better argument," says K. Hirsch, an analyst with American press Financial.

What's more, Fiorina is winning support from those who fear the uncertainty if she loses and steps down. Says Kevin Rendino, a portfolio manager with Merrill Lynch: "Sometimes the devil you know is better than the devil you don't know."

Peter Bur



AMERICA, LAND OF THE WEB SURFERS

AMERICA, YOU'RE ONLINE. According to U.S. Census data released on Feb. 5, more than half of all households and more than half of all Americans are connected to the Internet. As of last September, 54% of the population, or 143 million Americans, were using the Net. Not surprisingly, kids had the highest rate of computer use—90% of children between the ages of 5 and 17 use computers at home and school. Web use is increasing fastest in single-parent households: Usage rate has gone from 15% to 45% in five years.

GENERAL RE LOSSES BUFFET BERKSHIRE

WARREN BUFFETT'S BERKSHIRE Hathaway warned that its fourth-quarter earnings will take a hit, due to an under-

writing loss of \$1.27 from its reinsurance company General Re. This is the second straight quarter that Omaha conglomerate's earnings have been hurt by insurance losses. Last year it was a \$2.2 billion loss in September 11. Now, General Re has increased its loss from the World Trade Center disaster by \$170 million. Still, there has been a push to improve insurance underwriting standards at General Re, which changed management on Oct. 1, when J. Brandon became CEO.

ET CETERA...

- The Houston Astros to end their stadium-management agreement with Enron.
- Stock exchanges proposing tighter disclosure and conflict rules for analysts.
- JetBlue, one of the successful startups in the history, plans to go public.

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BY RICHARD S. DUNHAM

THE WHITE HOUSE: TOO SUCCESSFUL FOR ITS OWN GOOD?

These are days of bold pronouncements by the Bush White House. Fresh from routing the Taliban, George W. Bush now has an "Axis of Evil" in his crosshairs. And his macho style is increasingly evident closer to home. With his popularity at near-record levels, Bush seems to be almost itching for a showdown over Congress' demand that he disclose which industry executives met with Vice-President Dick Cheney's energy task force. And after months of delay tactics by Senate Democrats, the Administration is bypassing Congress through executive orders and recess appointments of controversial nominees—something Republicans criticized Bill Clinton for doing.

How over-the-top are the Bushies? With the midterm election campaign under way, Bush political mastermind Karl Rove told the Republican National Committee on Jan. 18 that the party should capitalize on the President's handling of the war and homeland security—sparking a furious reaction from Democratic allies in the war on terror. And on Feb. 4, Budget Director Mitch Daniels said New York lawmakers are in a "money-grubbing game" to win post-September 11 federal assistance—a comment for which he later expressed regret.

Is this combativeness evidence that success is going to the Administration's head? "They have to guard against hubris," warns a GOP operative. Such behavior has tripped other high-flying Presidents, from Nixon to Clinton. "Sometimes you believe you're Master of the Universe, and you lose your common sense," says ex-Clinton Chief of Staff John D. Podesta.

Bush is already paying a price for refusing to disclose the extent of Enron's contacts with White House officials and industry input in the formulation of energy policy. The President insists that he is simply trying to reclaim Executive Branch powers ceded to Congress since Vietnam and Watergate. He argues that Administration officials have a right to

hold confidential meetings to shape policy without later public disclosure. "It's not only important for us, Administration, it is an important principle for future administrations," Bush told reporters on Jan. 28.

The fight could be costly for the Bushies. "There is no justification to their argument," says University of Virginia government professor Larry J. Sabato. "But there are a lot of people in the political graveyard who made good arguments for losing propositions." Even GOP insiders view the clash as a public-relations nightmare that highlights ties to corporate fat cats. "They should go ahead and release the Cheney list," says one outside adviser to the White House. "The longer they wait, the more damage this will get."

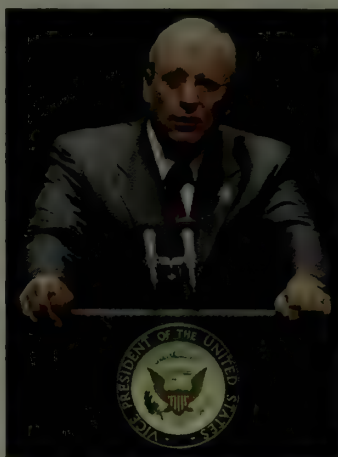
Indeed, a Jan. 24-27 ABC News/Washington Post poll indicates that 70% of Americans want the President to disclose all contacts with Enron. "The perception that the Administration is hiding something...reinforces the public's belief that [it] is too close to Big Business," says Trinity College political scientist Diana M. Swanson.

The White House offensive to reverse the erosion of Presidential power doesn't stop with stonewalling on the Enron task force. Recess appointments of Labor Secretary Eugene Scalia and Assistant

Secretary of State Otto Reich are the start of a drive to strengthen the confirmation process. And expect more initiatives to streamline executive order, like the end run around Congress that the volunteer Citizen Corps on Jan. 30.

White House strategists "are acting in a way that they have learned nothing from history," warns American University historian Allan J. Lichtman. In fact, the President, basking at 84% in the polls, seems to relish the challenge. And Congress looks ready to make his day.

With Lee Walczak and Paul Maguire



CHENEY: Mum on Enron

CAPITAL WRAPUP

COSA NOSTRA INC.

► The Enron scandal has given momentum to legislation that would subject corrupt execs to federal racketeering charges. The Private Securities Litigation Reform Act of 1995, passed over Bill Clinton's veto, limited securities lawsuits and banned investors from suing under the Racketeer Influenced & Corrupt Organization Act, better known as RICO. Representative John Conyers Jr. (D-Mich.) is leading the new charge to subject corporate conspirators to treble damages in civil

actions. While business lobbyists have fought off previous attempts to rescind the ban, they fear the Enron firestorm has changed the equation.

TIDE TURNS ON TERM LIMITS

► The term-limits movement, which boomed in the throw-the-bums-out heyday of the Gingrich Revolution, is on the defensive. Idaho, the nation's most Republican state, on Feb. 1 became the first to repeal its limits. Many of Gingrich's former House GOP troops have retracted personal pledges to leave Washington after six or eight

years. Why? With Republicans fighting to keep control of the House, party leaders believe that incumbents, with their proven fund-raising skills, are stronger candidates than newcomers.

HABLAMOS ESPANOL

► In its latest attempt to woo Latino voters, the Republican National Committee has agreed to pick up the tab for state party chairmen and spokespersons who want to learn Spanish. The committee will take a 10-day Spanish immersion course at Berlitz in Washington.

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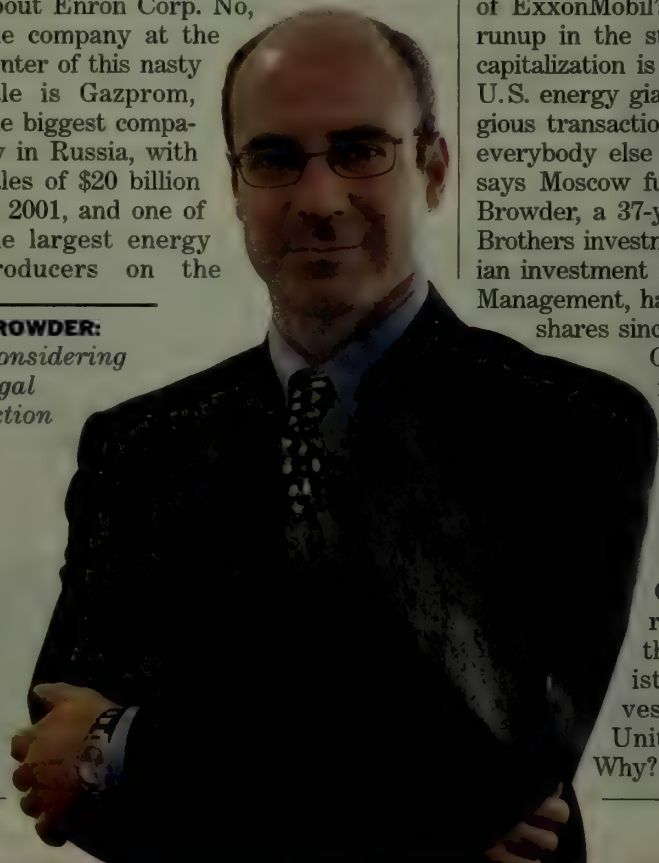
RUSSIA'S ENRON

Gazprom and PricewaterhouseCoopers are coming under fire

As financial scandals go, this one has everything. A Big Five accounting firm accused of overlooking wildly improper deals in its probes of a client's books. A client that's one of the country's biggest energy companies and is now a symbol for the evils of crony capitalism. The amounts involved? Billions and billions. There's more: leaked documents, infuriated shareholders, threatened lawsuits. Even the President of the country is angry.

Only one thing. We're not talking about Enron Corp. No, the company at the center of this nasty tale is Gazprom, the biggest company in Russia, with sales of \$20 billion in 2001, and one of the largest energy producers on the

BROWDER:
Considering legal action



planet, with reserves six times the size of Exxon Mobil Corp.'s. The auditor is PricewaterhouseCoopers, the world's largest accounting firm. PwC has been signing off on Gazprom's books since 1996, and fed-up shareholders say it is high time to give the job to someone else. Thus, Gazprom and PwC are at the center of a tempest whose resolution could decide whether corporate governance ever takes root in Russia.

Unlike Enron, Gazprom is not going bankrupt. But as with most stories involving Russia Inc., its tale is complex. In a nutshell, outsider shareholders accuse PwC of conducting dangerously lax audits of Gazprom, sheltering management from scrutiny over many questionable dealings. Longstanding perceptions that investors were not being told the truth about the company's financial position have kept the stock price severely depressed. Although its assets dwarf those of ExxonMobil's, and despite a recent runup in the stock, Gazprom's market capitalization is only a twentieth of the U.S. energy giant's. "PwC missed egregious transactions that were obvious to everybody else and hurt shareholders," says Moscow fund manager William F. Browder, a 37-year-old former Salomon Brothers investment banker whose Russian investment fund, Hermitage Capital Management, has been buying Gazprom shares since 1996.

Gazprom, renowned for its secrecy, is difficult to audit. Despite the apparent obstacles that PwC faced in getting information, the firm continued to sign off on the books anyway, says Gazprom independent director Boris Fyodorov, the former Finance Minister who now runs investment banking firm United Financial Group. Why? To keep the account, he

says. "If an auditor knows it can't do a proper review, then it is just doing it for the money," says Fyodorov.

Gazprom won't comment. PwC, bound by professional rules and its own prohibitions, won't comment on its work for clients. One Moscow partner, however, says the firm's critics lack PwC's grasp of Gazprom's inner workings. Nonetheless, Gazprom shareholders will vote in June whether to retain PwC as auditor. And everything is coming to a boil right now because of a confidential document floating around Moscow, a copy of which was obtained by *BusinessWeek*. It's a review of PwC's auditing of Gazprom that PwC itself conducted last year—and which essentially finds nothing wrong with the Moscow office's work.

PwC won't comment on the review. But Browder and others who have seen the document are up in arms about its findings. Browder's running for a board seat at Gazprom on a platform of firing PwC. Browder is also expected to work with Wall Street law firms the

AUDITING THE AUDITOR

Gazprom minority shareholders want to fire PwC

CRITICISM PwC had a conflict of interest in agreeing to review its own past work in a probe last year of financial ties between client Gazprom and Russian gas producer Itera

RESPONSE PwC says it assured the integrity of the review by having it conducted by auditors from offices outside of Moscow

CRITICISM PwC's Gazprom-Itera final report was a whitewash on behalf of Gazprom management

RESPONSE PwC declined to comment on specific aspects of the report, but says ill-informed critics have consistently been unable to prove improprieties between Gazprom management and Itera

CRITICISM Even though Gazprom pipeline contractor Stroitransgaz listed itself as majority-owned by Gazprom managers and relatives in a February, 1999, filing with Russia's Federal Securities Commission, PwC signed off on Gazprom financial reports for 1999 that made no mention of this "related party" tie

RESPONSE PwC, which disclosed Stroitransgaz as a related party in its 2000 report, declined to comment on the 1999 omission

Data: BusinessWeek



of launching a class-suit against PwC in U.S. on behalf of investors in Gazprom American depository receipts. The hook would be that investors bought the ADRs on basis of flawed audit opinions. He may yet find a key ally in his fight to oust PwC: The Russian government, which owns a 38% stake in the company. President Vladimir V. Putin himself is skeptical about the accuracy of the company's reports. "We've seen enormous amounts of money were spent," Putin told reporters in June. "The government has not tipped its hand about the vote on PwC. But Putin and his ministers are increasingly uneasy with the failure of auditing firms to identify misspending and improve transparency at Gazprom and other companies in which the government still has big stakes. "Auditors have been acting on behalf of management rather than shareholders," says Andrei Sharonov, a deputy minister at Russia's Ministry of Economics. Over the past decade, though, the

BIG PRESENCE: Price-waterhouseCoopers' Moscow headquarters

Kremlin let CEO Rem Vyakhirev run Gazprom as his fiefdom. Then last year Putin ousted Vyakhirev and replaced him with an aide, Alexei Miller, charged with cleaning things up.

Right now it's PwC that's in the hot seat. The focus is the review the auditor did for the Gazprom board last year on ties between Gazprom and Itera Holding Ltd., a Moscow-based gas producer. Suspecting that Gazprom management was using Itera as a front for the improper transfer of assets, a shareholder faction led by Browder sought to engage Big Five auditor Deloitte & Touche to investigate Gazprom-Itera transactions. Gazprom management was dead set against bringing in Deloitte & Touche, says Fyodorov. According to PwC sources, even some senior partners in the firm's Moscow office argued that any self-review would lack credibility. But PwC ultimately decided to have a probe done in-house and directed by a London partner. PwC delivered the report to Gazprom's board last July.

Copies of the report are now provid-

ing fresh ammunition to PwC's critics. Consider this convoluted example. PwC's review team examined a deal in which the province of Yamal-Nenetsk accepted gas from Gazprom as payment in kind for \$200 million in taxes. Local authorities sold the gas for a very low price to Itera, which then resold the energy to foreign buyers at what PwC in its report called a "significant profit."

Why couldn't Gazprom itself have sold the gas abroad for a rich price, paid its taxes, and made money for investors? The report says in-kind payment of gas saved Gazprom from borrowing cash at high interest rates to pay taxes. But according to a Hermitage analysis based on data from Russia's Audit Chamber, a government watchdog, Gazprom lost out on a \$5.5 billion pretax profit by paying the tax in kind.

Then there's the PwC review team's analysis of asset transfers from Gazprom to Itera. PwC found that Gazprom sold Itera a 32% stake in a gas-producing subsidiary, Purgas, for just \$1,200. PwC noted the market price could have netted Gazprom \$400 million and deter-

mined the deal was "advantageous for Itera." Why was this defensible? PwC's answer: Gazprom, afflicted by cash shortages due to Russia's financial crisis, lacked funds to develop the Purgas field.

That's weird, since Gazprom at the same time had the financial means to help Itera with \$616 million in loans, credit guarantees, and various services. "I don't know how auditors could condone this," Christopher Weafer, head of research at Moscow brokerage Troika Dialog, says of the asset transfers.

Faced with stonewalling from Itera, the PwC review team could not determine if Gazprom managers were beneficiaries of Itera. The firm, however, defends its record. "Nobody has ever demonstrated anything" that proves management siphoned off assets to Itera and pulled off other dubious deals, says Keith R. Rowden, the PwC partner who has supervised the Gazprom account since arriving in Moscow last March. Former Gazprom managers, meanwhile, deny owning any stake in Itera. Itera says it cooperated with PwC, but it did not have to tell PwC who gets dividends because PwC is not its auditor.

Another controversy centers on Stroitransgaz, a pipeline-construction company that landed more than \$1 billion in contracts from Gazprom. Stroitransgaz disclosed in a February, 1999, filing with regulators that Gazprom managers and relatives, including Vyakhirev's daughter, owned more than 50% of the contractor. But the 1999 Gazprom annual report, approved by PwC, did not mention any link to Stroitransgaz. "That you could attribute to a lack of required diligence on the part of the auditor," says Steven Dashewsky, an energy analyst at Capital Group Aton in Moscow. Gazprom execs have denied any wrongdoing. Under pressure from Fyodorov, Gazprom disclosed Stroitransgaz as a related party in its 2000 report. An aide for Vyakhirev says he will not answer any questions.

PwC is helping one large client, Russian oil major Yukos, move toward greater financial transparency. But with respect to Gazprom, many aren't inclined to give PwC the benefit of the doubt. "New management will never know what happened if they don't use a new auditor," says Mattias Westman, director of Prosperity Capital Management, a Moscow fund. Shareholders would push a new auditor to reopen the books and build a case for restitution of the company's assets. PwC's biggest job in Russia could yet prove its most painful.

By Paul Starobin and Catherine Belton in Moscow

COMMENTARY

By Irene M. Kunii

CAN KOIZUMI PULL BACK FROM THE BRINK?

Has Junichiro Koizumi committed political hara-kiri? That's the verdict of many analysts in Tokyo. After nine months of sky-high polls, the tousle-haired Japanese Prime Minister has watched his popularity ratings plunge from 80% to 50% in a matter of days. Koizumi triggered the slide when he fired his popular Foreign Minister, Makiko Tanaka.



It wasn't just the firing that ticked off Koizumi's supporters, though. Yes, many Japanese love the gutsy, outspoken Tanaka, one of the few politicians willing to openly fight corruption in the ruling Liberal Democratic Party. But they could have lived with her departure had Koizumi dismissed her for a valid reason—such as her consistently undiplomatic behavior toward Japan's foreign allies. Instead, Koizumi simply caved in to pressure from LDP elders, who were furious at her effort to uncover corruption and patronage in the foreign ministry. Koizumi clearly is either unwilling or unable to reform politics as usual. "People realize Koizumi never had any real power," says veteran political columnist Minoru Morita. "He's reached his limit."

Koizumi may still be able to reverse his slide by initiating painful

economic restructuring, but he will have to battle LDP elders. He also must try to loosen their grip on government power by abolishing the "tribes," parliamentary panels that oversee government-regulated sectors such as construction, transportation, and agriculture, and who veto related legislation. If he fails, his ratings may sink further, but at least he will have tried.

Whatever happens, Koizumi's days may be numbered. Former Premier Ryutaro Hashimoto, the powerful faction chief who plotted Tanaka's downfall, believes he can oust Koizumi. The buzz on Nagatsuma Hill, Tokyo's political headquarters, is that Hashimoto and several other LDP power brokers are eyeing Koizumi's job. The opposition, meanwhile, is growing stronger by the day. Koizumi could lose an upcoming debate

NO MORE MR. COOL

By bowing to the LDP

chiefs, Koizumi has lost his credibility among voters

linked to the construction industry

Koizumi could try one last desperate act to prove his mettle: Call a snap election for the Lower House. An option he said last year he would consider. The problem is that if he acted against the LDP, he'd find himself out of a job before the campaign even got under way. Gerald Curtis, a Columbia University expert in Japanese politics, rules out any such gambit. "The most likely scenario is that Koizumi will stumble along as nothing will get done," he predicts. That, as we all know, is politics as usual in Japan.

Kunii writes about business and politics from Tokyo.

FREE TOUGH WNS

faces difficult talks in
ing, Seoul, and Tokyo

e's the warrior President: the man who threw down the gauntlet against terrorists and the "axis of evil"—rogue states secretly facturing weapons of mass de-
ion. George W. Bush is also the everyone is counting on to do
hing about the worldwide reces-
After all, the U.S. needs allies
erous enough to carry out their
in Washington's global security
plan.

ese topics—terror and the global
my—will head the agenda for
as he visits Tokyo, Seoul, and
g starting Feb. 17. In each coun-
ush has focused, and sometimes
messages to deliver. One irony is
he U.S. delegation's friendliest
ion may be from the Chinese—
a year ago, with a U.S. spy plane
red and its crew on the ground
ina, were being held up as a
to global security. Bush's visits to
South Korea and Japan, by con-
could be fraught with tension.
e how each leg of the trip is likely
y out:

ing. Bush's meetings with Presi-
Jiang Zemin and Premier Zhu
i on Feb. 21-22 will be the last
asiest leg of the trip. The Bush
will thank the Chinese for backing
anti-terrorist drive and for not
g to block American military
in Central Asia, close to the Chi-
border. Neither country wants rad-
lamic movements to spread. "Now
sides see more common ground,"
senior Chinese government official.
h, however, will keep pressing the
se to stop selling weapons tech-
y to rogue states. Says a senior
nistration official: "We have to
clear to them [that] we watch
they do." The U.S. just sanctioned
Chinese companies for selling Iran
cts that can be used to make
cal weapons.

e Taiwan question hasn't gone
of course. The Chinese will lecture
U.S. on selling Taipei high-tech
onry. The U.S. will stand firm.
good news is there's only one
em that's at all serious," says
el Mandelbaum, a senior fellow at
ouncil on Foreign Relations. "The
ews is it's insoluble."



BUSH'S DELICATE ASIA AGENDA

CHINA Beijing and Washington are in sync on the war against terrorism. But the U.S. still has gripes about China's weapons sales and human rights record.

JAPAN The Bush team wants Japan to assume a bigger regional security role and get its economy in order.

SOUTH KOREA Tension is high over Bush's listing of North Korea as part of the "axis of evil," which throws a roadblock in front of President Kim Dae Jung's conciliatory "sunshine policy."

Date: BusinessWeek

■ **Seoul.** Bush's decision to name North Korea as one of three top troublemakers in his State of the Union speech didn't sit well with South Korean President Kim Dae Jung, who has staked his presidency on a dramatic opening to Pyongyang. "The key word with North Korea is 'dialogue,'" said South Korean Foreign Minister Choi Sung Hong not long after Bush's remarks. The Americans will tell Kim that they, too, want an opening with the regime of Kim Jong

BUSH AND JIANG: "More common ground"

Il—but that they think South Korea has gone soft on the issue. Washington is waiting for some sign that Pyongyang is willing to stop selling missile technology and allow inspections of its nuclear facilities. The U.S. strategy is to use pressure, rather than conciliation, to force North Korea back to the negotiating table.

■ **Tokyo.** Bush's dealings with Prime Minister Junichiro Koizumi will be the toughest part of his trip. Koizumi's credentials as a reformist are in tatters (page 52), and Japan's economy is sinking deeper into recession and financial distress. Worse, Bush's staff is divided on just what to do to end the Japan crisis. Economic adviser Lawrence B. Lindsey backs a weak yen, which helps Japan's hard-pressed exporters. But Treasury Secretary Paul H. O'Neill opposes efforts to drive down the yen unless they are linked to broader reforms. "Beggars-thy-neighbor policies don't work," says an Administration official who sides with O'Neill. The betting is that Bush will urge the Japanese privately to clean up their bad bank debt fast and stop relying on a weak yen to bail out the economy. If reform continues to stall, though, Washington could go public with its complaints.

Bush also sees Japan's crisis as a security issue. Bush will tell Koizumi that Japan can never ramp up its armed forces until Japan starts growing again. The U.S. is concerned

about Japan's economy "because of the role Japan seeks to play as a security partner for the U.S.," says R. Glenn Hubbard, chairman of Bush's Council of Economic Advisers. If Japan fails in that role, then archrival China can throw its weight around—and Bush will have plenty of new problems to deal with the next time he visits the region.

By Stan Crock and Rich Miller in Washington, with Moon Ihwan in Seoul and Dexter Roberts in Beijing

SOUTH KOREA

DAEWOO: STUCK IN NEUTRAL

Why GM's buyout of the carmaker can't get going



When General Motors Corp. agreed to buy a controlling stake in South Korea's Daewoo Motor Co. last September, all parties concerned breathed a sigh of relief. Finally, it seemed, a drawn-out drama that had included an abortive bid by Ford Motor Co., passionate union opposition to foreign ownership, and a storm of political controversy was near an end. GM would salvage the Korean auto maker by buying its best assets, boosting government efforts to force sales of other distressed companies. The whole thing was to be wrapped up by yearend.

More than a month later, the deal remains undone. Negotiators are still arguing over how to value the assets and potential liabilities of two dozen Daewoo subsidiaries around the world and how to use its sales networks. The Daewoo Auto Workers Union still has issues with the takeover terms. Meanwhile, what once was Korea's No. 2 carmaker is wasting away, and suppliers are being pushed to the wall.

The Daewoo impasse is adding to the general unease over the Korean government's asset-sale program. In recent months, foreign investors, fed up with high asking prices and a refusal to separate good assets from risky ones, have halted talks to buy majority stakes in Seoulbank, Hanbo Steel, and Korea Life Insurance. Last month, American International Group pulled out of a U.S. consortium negotiating a \$1.5 billion takeover of Hyundai Securities and two

other ailing Hyundai Group financial units. No one is more embarrassed than Finance & Economy Minister Jin Nyum, who has often cited the sale of the Hyundai units and Daewoo Motor to foreigners as proof Korea is serious about corporate reform. "It's not desirable to delay sales of distressed assets," Jin now says. But, he adds, "you can't neglect important negotiations. Excessive demands won't be met."

People close to the GM-Daewoo talks figure an understanding can still be reached. GM badly wants Daewoo as an Asian beachhead. And without GM, Daewoo Motors will collapse. Also, GM and Daewoo's creditors have agreed on the \$400 million price. "GM is still strongly committed to buying Daewoo," says Kay Lee, a GM Korea executive. "But we have to bring an acceptable deal to the board of directors."

But as the talks drag, Daewoo Motor gets weaker. In 1999, when it was declared insolvent, Daewoo had a fifth of Korea's vehicle market and a third of passenger car sales. Last year, it built

GUAN SAN PLAN
Daewoo is running one-third of capacity

fewer than 12% of 1.46 million vehicles sold in Korea. Daewoo now operates at less than a third of capacity. Daewoo released a new car line in 1999. Two new cars are planned for 2000. But without help, they are expected to do well.

Suppliers, worried about being stuck holding \$1 billion in IOUs, are all hurting. "We've been muddling through by borrowing," says Hang Kyun, CEO of Daeshin Machine

dustries Co., which sells gearshift hand-brake levers to Daewoo. "Maybe we could go belly-up unless cash improves soon." Joe, leader of a Daewoo suppliers group, says a quarter of the 212 members could be bust by July.

One holdup to the GM deal is Daewoo's union. Despite losing their radical leaders, the union's demands for a say over the number of layoffs and asset sales. GM wants to lay off 1,700 workers. The union also insists that a quarter of the 1,700 workers laid off over the next year be rehired in 2002, and the rest by the end of next year. Daewoo executives pledged only to try to rehire 200 workers. The hope is that pragmatism will prevail. Says Han Dai Woo of Korea Development Bank, Daewoo's primary creditor, "The union is the problem."

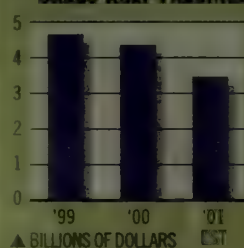
That may yet happen. On Feb. 1, union boss Kim Il Seob and several other union leaders were sacked. Workers surrendered to the police after holding a year-long sit-in at a church near Daewoo's oldest, least efficient plant in Bupyeong. Kim, who was charged with organizing illegal protests, will let another union official lead the talks. But few expect a breakthrough soon. Kim's term doesn't expire until September, when he's expected to be replaced by a moderate.

One way to break the logjam is for Seoul to mediate and offer a safety net and job training for laid-off workers. But with elections looming, says a Labor Institute researcher Bae Ki, "nobody in the government is willing to stick out his neck." The worst scenario: When finally all of the parties come to terms, Daewoo is so crippled that GM no longer wants it.

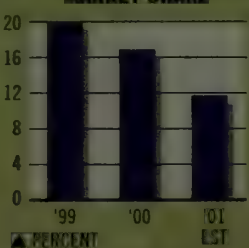
By Moon Ihlwan in Seoul

SPUTTERING

DAEWOO'S KOREAN SALES KEEP FALLING...



...AS DOES ITS DOMESTIC MARKET SHARE



Data: Daewoo Motor Co.



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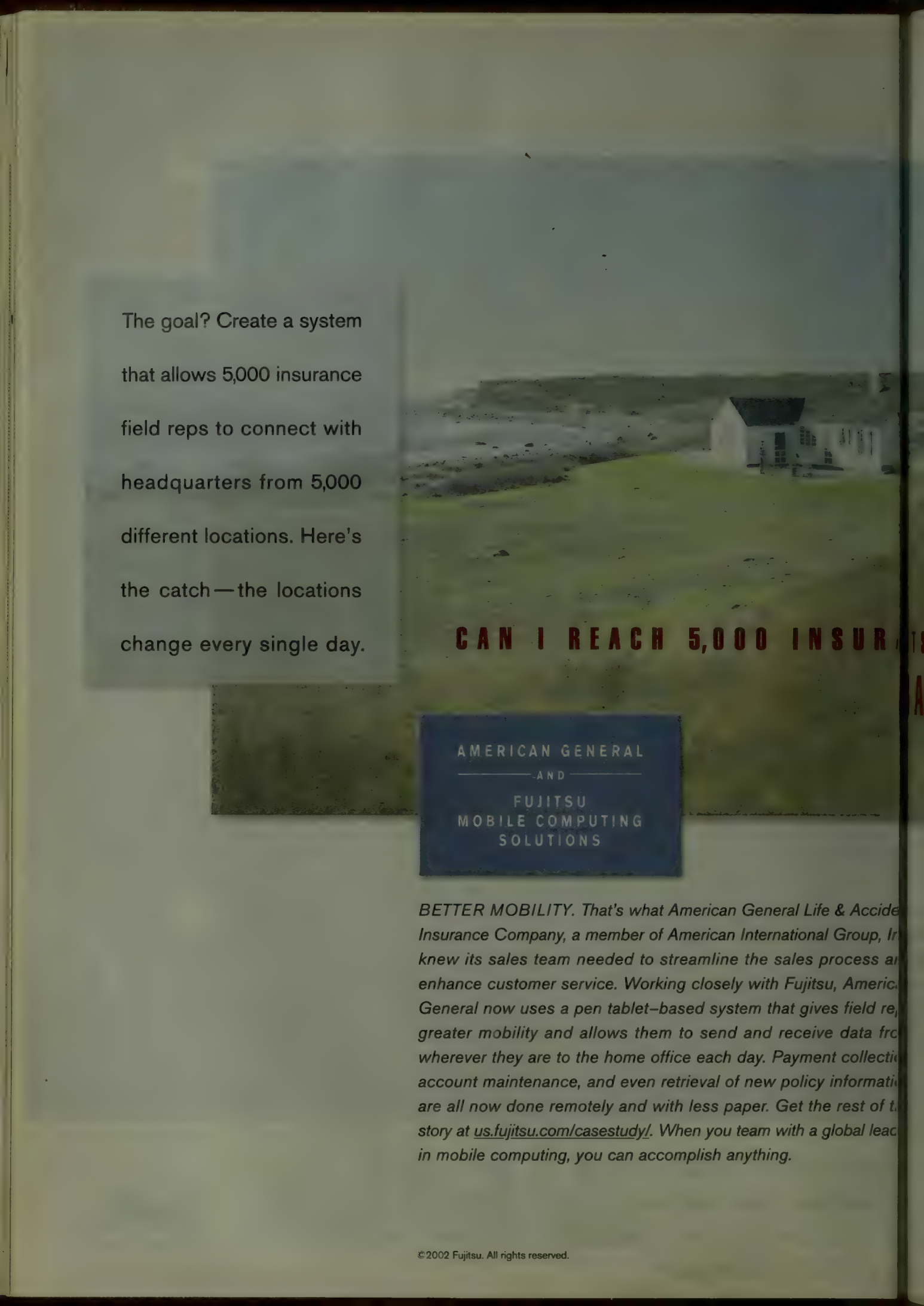
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field reps to connect with
headquarters from 5,000
different locations. Here's
the catch—the locations
change every single day.

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EDITED BY ROSE BRADY

FRANCE: WHY CHIRAC'S WEAKNESS COULD CRIPPLE REFORM

These are anxious days for French conservatives. For months, polls showed their standard-bearer, President Jacques Chirac, beating his likely opponent, Socialist Minister Lionel Jospin, in this year's election. But the first round of presidential voting set for Apr. 21, a twist in a long-running corruption scandal has nearly led that lead.

After seven years on the lam, Didier Schuller, a former official of Chirac's Rally for the Republic (RPR) party, turned himself in on Feb. 5. Schuller is ready to finger RPR officials, including the President, in an investigation of alleged kickbacks while Chirac was Paris' mayor from 1977-95. Chirac's support has slipped 5 points since *l'affaire Schuller* is making headlines in mid-January.

That's only the beginning of conservatives' woes. Under the French system, the party that controls Parliament effectively runs the government. The right, which lost its majority in 1997 to a Socialist-led coalition, hopes to regain control in parliamentary elections in a month after the final presidential vote. If Chirac loses, his task will be almost hopeless.

Even if he wins, scandal-tarred Chirac isn't likely to give his troops much momentum for a parliamentary victory. Compared to the Socialists, the conservatives look ill-prepared for battle. In the past five years, the right has splintered from four into six parties. Chirac, 69, has discouraged the emergence of new leadership and fresh ideas. Onetime favorites such as Alain Juppé, who was ousted as Prime Minister in 1997, and Philippe Seguin, who lost his race for Mayor of Paris last year, are too weakened to play key roles in a new government. Most analysts think the right's candidate for Prime Minister will be a political unknown. "The big

problem for the right is that there's no one behind Chirac," says Pascal Perrineau, an analyst at the Paris-based Center for the Study of French Political Life.

The Socialists have much greater bench strength—in part because Jospin, 64, has worked hard to accommodate differing factions in his coalition. Centrist Socialists such as Finance Minister Laurent Fabius and former Finance Minister Dominique Strauss-Kahn are appealing to moderate voters by calling for tax cuts and privatization of state-controlled companies. Strauss-Kahn, who left the government in 2000 to face a corruption investigation in which he was cleared, is a top contender for Prime Minister if the left stays in power.

For all his troubles, Chirac maintains a slender lead over his Socialist opponent. If, as expected, Chirac makes it to the

second round of voting on May 5, most polls show him getting 51% to 52% of the vote against Jospin. Chirac is charismatic and a strong campaigner, while Jospin is colorless and aloof. And as leader of the current government, Jospin is vulnerable to attack over France's worsening economy. Chirac has also rebounded from earlier scandals, including the disclosure



JOSPIN AND CHIRAC: Neck and neck for the presidency

that he paid for luxury vacations with bags of cash from undisclosed sources. Other investigations have foundered because Chirac can't be prosecuted while in office.

So what would happen if France had another five years of cohabitation between a conservative President and a leftist Parliament? Not much, and that's the problem. Without the political oomph of the presidency, neither the left nor the right would find it easy to push through badly needed measures such as overhauling the retirement system. In this election, reform could be the real loser.

By Carol Matlack in Paris

GLOBAL WRAPUP

ISRAEL'S MISSILE AMBITIONS

Israel is seeking U.S. approval to test its Arrow ballistic missile system, Israeli military sources say. The U.S. is looking for a third of the \$2 billion development cost of the land-based system, which is designed to shoot down incoming missiles, and has the right to export its sale to countries other than Israel. Israeli Defense Minister Benjamin Ben Eliezer recently raised the issue in talks with Defense Secretary Donald H. Rumsfeld. Turkey, India, Britain, and South

Korea have all expressed interest in buying the Arrow, which was developed by Israel Aircraft Industries Ltd. and would sell for an estimated \$3 million. Israel Aircraft Industries recently signed an agreement with Boeing Co. to market the missiles and manufacture half of each system.

BLAIR'S LABOR WOES

► Jousting between Prime Minister Tony Blair and Britain's labor unions could jeopardize Blair's plans for a growing private sector role in the London Underground and the National

Health Service. Striking rail unions have recently disrupted commuter traffic in London and other cities. Blair enraged the unions on Feb. 3 by calling them "conservatives who believe the old ways will do."

Labor unrest is likely to increase. Although strikes won't jeopardize Blair's majority in Parliament, they may hamper his efforts to improve transport, health, and education. Blair's Labour Party is likely to be judged on the quality of these services in the next general election, which must take place by May, 2006.



The Ultra
Driving Machine

BusinessWeek

February 18, 2002

e.biz

A REPORT ON ELECTRONIC BUSINESS

WIRELESS WEB

From Pepsi to Office Depot, New Networks Pay Off

UPSTARTS

Can DoubleClick Defy the Ad Slump?



The **NEW** Teamwork

Virtual teams from different companies band together over the Web to make products faster and cheaper. Here's what you can learn



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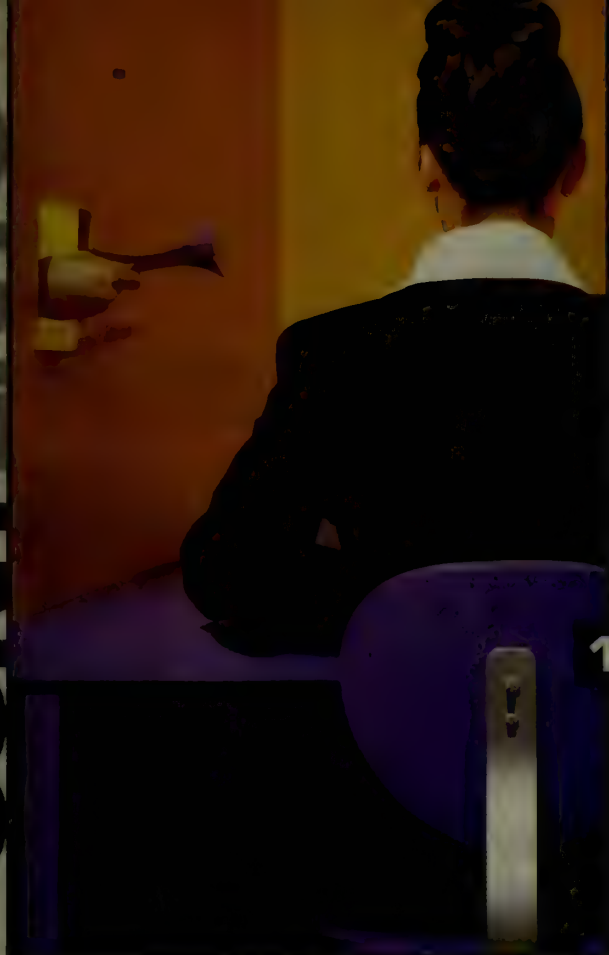
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COVER STORY

The New Teamwork

Companies have long talked about the so-called virtual corporation, one that focuses on what it does best and farms out the rest to specialists. Now, a new generation of Internet-collaboration technologies is making it easier and cheaper for companies to work hand-in-hand with their partners to bring new products to market in record time—and on penny-pinching budgets. From Lockheed to GM to Georgia Pacific, the pioneers already are reaping the rewards

FEATURES

4. Home Page

The financial crisis boosts e-banking in Argentina; jobless techies are mobbing libraries; and warming up IPOs

8. Web Smart

Winging Into Wireless

Once written off as overhyped and underperforming, wireless is undergoing a quiet resurgence. For some companies, it's already paying off big



18. Upstarts

DoubleClick, Take Two

The online ad leader got hammered last year as the bottom dropped out. But now it's branching into new businesses, snapping up competitors, and heading for profits



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COMMENTARY

5. Data Mine

Beware of Optimists

The tech industry has a nasty habit of producing market research that's wildly optimistic, so be careful when basing business decisions on it

6. Clicks & Misses

Napster They're Not

The new online music services, RealOne and pressplay, still don't get the idea of providing a broad catalog cheaply and conveniently

7. Digital Lifestyle

Hooked on BlackBerry

They're sprouting all over: BlackBerry pagers that pipe e-mail to your hip 24/7. But their users are prone to some odd behavior

E-BANKING TANGO

Here's one way to jump-start online banking: wreck your economy, slap controls on cash withdrawals from banks so consumers can't drain every last peso from their accounts, and voilà! e-banking takes right off.

That's one lesson from Argentina, where the economic crisis has made consumers reach for the mouse. When authorities limited monthly cash withdrawals to 1,500 pesos (now about \$1,070), bank lines grew, cramping the style of Argentines accustomed to paying bills in cash. Since checking accounts are rare, Argentines are turning to the Web to extract money from savings accounts and pay creditors—avoiding the hassles of both lines and illiquidity. Red Link, one of two companies that manage Web sites for Argentine banks, says online transactions on its network jumped 314% in December, to 1.9 million—in a nation of 3.1 million Web users. Competitor Banelco says its Web transactions rose 282%. “It was ridiculous standing in those long lines,” says student Inés Vernengo.

No one knows whether Argentina's tango with Web banking will last, though Vernengo says she's hooked. But Argentines, whose pesos were devalued 29% on Jan. 6, might think they have bigger problems anyway.

—Aixa M. Pascual



Sorry, Time's Up!

The latest fad among jobless techies in San Francisco? Taxpayer-funded Internet access at public libraries. “I had access at \$50 per month when I worked there’s no way I can afford that now,” says Molsen, a 25-year-old dot-com layoff victim.

As local unemployment has surged to 5.7%, once-quiet bookworm oases are now swarmed with surly surfers. Weekday demand for the main library's 300 computers is so high that administrators split them into “express” terminals, with a 15-minute wait, and 1-hour terminals—with strictly enforced waiting lists. “It’s like a stampede in the morning for the sign-up sheet,” says library spokeswoman Marcia Schneider. “Somebody has to hold people back.”

Librarians say the congestion has sparked Web rage. In December, one patron screamed for 10 minutes at a librarian who kicked him off a terminal. “He threatened to sue,” says Eleese Longino, 26, a patron who saw the incident. For some, the term “Internet craze” may be taking on new meaning.

—Brian

The Water's Still Cold

Tech stocks have been hot lately, but not hot enough to ignite IPOs. A handful are planning to go out, but they may face a mixed reception. Here's a sampling:

COMPANY	GO PUBLIC DATE	VALUATION
Synaptics	January 29	\$280 million
The skinny: Strong debut for touchpad maker, which has \$83 million in sales and was profitable for two of the last three years. Stock rose 19% on the first trading day.		
PayPal	Early February	\$830 million
The skinny: Leading online payments company grew 1,000% in the first nine months last year but lost \$89 million. High valuation, but Street likes it anyway.		
InterVideo	TBA	TBA
The skinny: Maker of DVD-editing software for PCs plans to expand into home networking. Lost \$5.9 million in first nine months of 2001 on \$23.7 million in sales.		
Verizon Wireless	TBA	TBA

The skinny: Largest U.S. wireless carrier made about \$1 billion in 2001, but spin-off was delayed amid telecom turmoil. Don't expect a deal before summer.

Data: Renaissance Capital





ROGER O. CROCKETT
 ger_crockett@ebiz.businessweek.com

Beware of Optimists

Don't base your business decisions on overly upbeat market research

AM NO SOOTHSAYER, but I had a hunch the online grocery business would spoil like a carton of outdated milk. So when a buddy told me he planned to give up his job with software giant Oracle Corp. for a post at Internet grocery startup Webvan Group Inc. a couple of years back, I scoffed that IPO mania had turned his brain to cottage cheese.

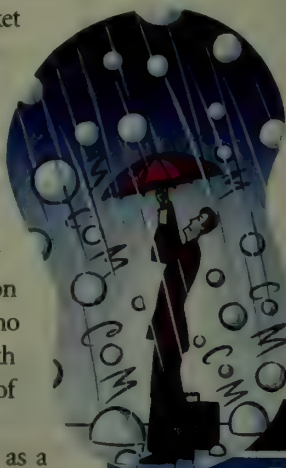
By last July, Webvan's wheels had come off, and my buddy was rummaging the classifieds. He didn't see it coming, but then neither did a lot of folks. Among the most surprised must be researchers at Jupiter Media Metrix. They said online groceries would be a \$2 billion business last year—more than twice the \$800 million reality. Before you lay too much blame on Jupiter, though, remember that most analysts once sang the praises of ill-fated online endeavors such as selling postage stamps and pet supplies. It's a bit odd: The tech industry can make supercomputers that handle enough complex calculations to predict the weather but can't produce market data that holds up much longer than a thunderstorm. When forecasting tech market trends, analysts span the map like a bunch of lost tourists. EMarketer Inc., a researcher that updates Net forecasts, checked predictions for high-speed Net access that 16 analysts made in 2000 for 2001. Only six got within 10% of 11 million U.S. homes that had broadband by yearend. London-based Ovum Ltd. apparently threw a dart and missed, predicting 15 million users. Again, I'm not clairvoyant, but anyone who's tried broadband knows that at \$50 a month it costs too much. Plus, it takes the tech skills of an engineer to get it working.

What gives? The worst forecasts are made as a market's hype-to-reality ratio is at its peak. In 1999 and early 2000, when the world was buzzing about the promise of Web media, most researchers guessed that banner ad sales would explode. AdZone Research Inc. estimated that online ad sales would hit \$16 billion last year. But banners bombed: Just 0.3% of Web surfers clicked on them. So ad revenue finished last year at \$3 billion—10% lighter than in 2000.

I asked the researchers for an explanation. They all try to account for economic slowdowns,

funding shortfalls, and demand shifts. Obviously, no one could have predicted September 11, and seeing the depth of last year's tech downturn wasn't easy. But researchers need to question the hype companies feed them. Ovum, for instance, says its predictions were colored by telecom companies' ambitious development plans. "We sort of cheerfully assumed [managers] knew what they were talking about," says analyst Tim Johnson. And Jupiter analyst Ken Cassar says he based his forecast of grocery sales in part on Webvan's predictions of rapid expansion. "The market didn't develop nearly as quickly as we thought," Cassar says.

That's an understatement. Jupiter now says online grocery sales this year will be \$1.2 billion, a shadow of the \$4.2 billion predicted two years ago. The lesson here is that you need to be ready for both boom and bust. Cost-conscious companies such as shopping site BizRate.com are still around because they didn't get suckered by upbeat forecasts. "As a kid, I saved my Halloween candy for the entire year," says BizRate CEO Chuck Davis. "In a Net business the same principle applies: Save the money for a rainy day." If market researchers and Webvan's managers hadn't bought each other's hype, the online grocer might still have its wheels and my buddy might still be rolling along with it. ■



Forecasting Flop

E-commerce was supposed to soar last year. Instead, it slowed dramatically. Will 2002 predictions be more reliable?

	HIGHEST 2001 PREDICTION	2001 REALITY	HIGHEST 2002 PREDICTION
Online advertising revenue	\$16.0 billion	\$7.3 billion	\$9.0 billion
Homes with broadband	15.0 million	11.0 million	22.4 million
Wireless Web users	15.0 million	8.9 million	22.5 million

Data: eMarketer Inc.



BY TIMOTHY J. MULLANEY
tim_mullaney@ebiz.businessweek.com

Napster They're Not

The music industry's online offerings hit more sour notes than sweet

WHEN RECORD COMPANIES sued Napster Inc. in 2000, the first casualty (after Napster itself, alas) was common sense. On one side of the debate were bug-ridden Napster imitators intent on abetting the piracy of intellectual property. On the other was a no-growth music oligopoly that was late to the Internet—then insisted no music service go online without itself in charge. Choose your poison.

The solution is obvious: Web music services should be cheaper and more convenient than a store. They should pay artists and provide reliable downloads. They need every tune most people want and lots they don't yet know, like a good store has. Right?

So why don't pressplay and RealOne Music, two new industry-backed Web music services, understand this? A test drive reveals weak selection and pricing that's not attuned to how people want to buy music. Both flunked the same test Napster passed in 2000: Could they match my own, suburban-bought, CD collection? Hardly. RealOne couldn't find Beethoven's *Ode to Joy*. No Otis Redding. No zydeco titan Clifton Chenier. No Dar Williams or Richard Shindell, folk acts reviewed in *haute couture* magazines such as *People*. No Clancy Brothers, a top Irish band. How about Top 40? No Jennifer Lopez. No Alicia Keys.

Pressplay also has gaps big enough to march a band through. It has 19 Beethoven cuts—by 1980s band Camper Van Beethoven. It misses Chenier. It has the Clancy Brothers but not their sometime-partners, the Dubliners. No Shindell, but Williams is here. No Redding. It has Lopez—but just two tracks from her *J.Lo* CD. No Keys. A search for *NSYNC yielded The Nixons—until I misspelled *NSYNC's name and found nine songs. Most *NSYNC is on RealOne.

The reason for the gaps is simple. On pressplay, there are mostly songs recorded for Sony, EMI, and Universal. RealOne is built around Warner Music, BMG, EMI, and Zomba. Selection will improve as licensing deals get cut, but now neither keeps up with the what's available on free song-sharing services such as Morpheus, which like Napster is battling the industry in court. And neither matches a good store's breadth of selection.

RealOne and pressplay aren't cheap, either. A CD is like an honest Chicago politician: It stays bought. Both pressplay and RealOne use rental pricing: For \$9.95 and up per month, you can play songs you download on your PC, beginning at 30 songs a month at pressplay and 100 a month at RealOne. (But RealOne bars you from transferring songs to portable music players—a major faux pas.) For a year, pressplay costs \$119.95 and lets you use 360 songs—the equivalent of about 24 CDs. (On RealOne, it's about 80 CDs). To get most of the artists I want, I'd need both services, about \$240 a year. Since I keep CDs about 10 years, I'd spend \$2,400 to keep listening for good. RealOne and pressplay, however, may make economic sense for some people. For those who buy a few cuts from a CD rather than the whole thing, or those who tend to listen to a song for a short time and then move on, the services may be priced right.

Otherwise, RealOne and pressplay serve record companies, not consumers. Britney Spears said it up: Oops, they did it again. ■



Roll Over, Beethoven

The music industry's first efforts at pay-for-download Web services have big problems.



RealOne: Service has alliances with only three of the top five record companies, meaning big gaps in selection. Plus, it's expensive at \$9.95 a month and up.



Pressplay: It offers a different three of the big five, meaning different artists are unavailable. And you get fewer downloads for the same \$9.95 fee—30 per month, vs. RealOne's 100.

JOAN O'C. HAMILTON

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Hooked on BlackBerry

These e-mail pagers are capturing the digerati—and spawning some weird behavior

FARZAD DIBACHI WAKES up every morning and immediately kisses his wife, Rhonda. That's to remind her how important she is, Farzad explains, as Rhonda rolls her eyes. Why does the lovely Rhonda need this reminding? Because Farzad then reaches for his BlackBerry e-mail pager and spends the next half hour in bed, assorted minutes while getting dressed, and a disturbing amount of time while driving to work (at red lights only, he insists), squinting into the pager-sized device and zipping off quick e-mails. "I love it," admits Dibachi, CEO of software company Niku Corp. "I hate carrying a laptop just to do e-mail."

If you haven't seen BlackBerries, made by Canada's Research In Motion Ltd., they come in two sizes: A pager look-alike, and a palm-size device. Both have tiny keyboards you work with your thumbs, and they wirelessly pipe your e-mail to your hip, 24/7. To many of us that sounds disturbingly like the ankle bracelets they use on felons under house arrest. And frankly, the first time I saw one I thought it was a toy that had slipped its pinky out of its tie in the Knowledge Worker Barbie accessory pack. Who in the world could type on keys the size of a grain of rice?

Anybody with thumbs, I've discovered. I now see legions of BlackBerry fans in meetings, around town, even in church. There's something really nice about being able to type in private," says Yogen Dalal, a venture capitalist at Mayfield Fund who says he quickly got used to the tiny keys. And users are adopting a slew of quirky private and public behaviors. E-mailing in the bathroom, for example. Or obviously entertaining onlookers in public by scowling, swearing, or even verbalizing their scrolling and typing into the tiny screens. "dit-dit-dit-daaaa—Send!" they yelp. And I get lots of brief e-mails from BlackBerry users written in vowel-optional shorthand at Redwood City (Calif.) lab technician Evelyn Miller calls "Vanna-lan-gage"—(c u @ th mtng).

Jill W. Mullen is a chief technology officer at Merrill Lynch & Co., a big BlackBerry cus-

tommer. She says her investment bankers especially love the devices, but their impact is being felt all over the company. For example, Merrill meetings are now judged successes or failures based on how many people whip out BlackBerries instead of paying attention, she jokes. I'm told many users now call the increasingly familiar BlackBerry posture of head down, hands in the lap under the conference table, the "BlackBerry prayer."

Obviously, the device's biggest appeal is real-time info: Smythe European Motors ace Mercedes salesman Tony Spencer says his BlackBerry has won him sales from his demanding Silicon

Valley clientele, such as when his sales manager e-mailed the salesforce that a silver version of a \$90,000 car Spencer was test-driving with a client had become available. Spencer paged back "SOLD" on the spot. "I wouldn't take a call in that situation, and the car would have been gone by the time we got back,"

he says. Los Angeles attorney Nancy L. Abell even uses her BlackBerry at the bargaining table. During a difficult negotiation she zapped a change in strategy to one of her colleagues just a few chairs away. "He responded, and we were set," she says.

But can folks keep their BlackBerry use responsible, polite, and lawful? Already, some users defy airline rules about turning off devices by hiding them in their laps. Tony Spencer's wife, Chris, likes his love notes, but not the thought that he's in the car driving and typing at the same time.

Oh, and one last caution to the Silicon Valley venture capitalist who "prays" often throughout the day: Your assistant does not recall BlackBerry-directed Starbucks runs being in her job description, Bucko. ■



Winging Into Wireless

It's cheaper and easier to install—and more companies are finding that it pays off big

BY HEATHER GREEN

THREE YEARS AGO, U.S. Fleet Services considered building a wireless network for its drivers, but soon decided against it. Customizing mobile devices and developing software was too hard, and the company didn't have computer systems robust enough to make it worth the hassle. Then, last year, U.S. Fleet revisited the technology—and this time it put the pedal to the metal.

The reason? These days, wireless is cheaper and easier to deploy—and it's already paying off. In September, U.S. Fleet, which refuels vehicles for customers such as Coca-Cola and Nabisco, began equipping its 200 trucks with mobile devices and wireless connections to its corporate intranet. The price: \$1.5 million, a quarter of what it would have cost three years earlier. Now, managers can check drivers' locations online, letting them rearrange routes on the fly—and increase the average number of daily deliveries per truck from six to seven. As soon as drivers fill a client's vehicle, the information is scanned into their handheld computers and zapped off to the network. That lets customers check deliveries immediately on U.S. Fleet's Web site, two days faster than before the system was installed. Wireless "makes good business sense and doesn't cost an arm and a leg," says Saul Cohen, vice-president of information technology at U.S. Fleet.

Once written off as overhyped and underperforming, wireless is enjoying a

resurgence in Corporate America. Thanks to plunging equipment prices, new standards for radio links, and increased cellular coverage, even small companies can afford wireless systems once available only to deep-pocketed giants such as United Parcel Service Inc. "During the past 18 months, companies staggered around, not quite sure whether to touch wireless," says Martin Dunsby, a partner at Deloitte Consulting. "Now the interest is accelerating."

What's fueling the growth? Device makers, ranging from well-known names such as Palm Inc. to industry stalwarts like Symbol Industries are churning out smarter and smaller handhelds. Symbol's standard machine, for example, has gotten a tenfold boost in performance since 1999, while its price and weight have fallen by a third. That makes it cheaper for companies to equip workers and has cut the price of wireless projects in half over the past two years, says researcher IDC Corp. That, in turn, will help double the number of field reps with wireless devices, to 11

million, this year, says Yankee Group research Inc. And in hospitals, offices, factories, a standard called WiFi (a.k.a. 802.11b) that connects devices to wireless networks is simplifying installation. This year, employees using WiFi networks are expected to more than double, to 10 million, according to Gartner Inc. Another boost: Tiny radios can now track people in warehouses or alert techies when machines are on the blink.

Still, lingering design and technical issues need to be ironed out. Some companies are waiting for the higher-speed wireless networks that phone companies such as Verizon Wireless and Sprint Nextel Group are promising this year. Without those networks in place, companies' wireless initiatives won't have sufficient reach to make them pay. For instance, coffee distributor Millstone Coffee gave handheld computers to 400 field reps last fall but has delayed wireless linking them until connection speeds and coverage improve. And security holes uncovered last year in WiFi technology have sparked concerns about hackers intercepting corporate data.

The biggest action is in reaching out to field personnel. In years past, Pepsi Bottling Group Inc.'s 700 soda fountain technicians spent too much time on the phone instead of time fixing the company's 1.3 million vending and fountain machines. Customers called in problem machines, then a call-center employee paged a technician, who would ring for details about the job. At the end of the day, repair workers would fax in forms detailing the visits—with results not available on Pepsi's intranet until five days later.

That system is on its way to the trash heap. Pepsi's technicians now have off-the-shelf handheld devices from Armonk, N.Y.-based Melard Technologies Inc. Dispatchers today retrieve from Pepsi's intranet everything the technicians need to know about a job and zap it off to a paperback-sized handheld. When the job is done, the technician sends an electronic bill to headquarters. At the same time, the handheld automatically tells the store





Wandschneider: Fewer errors—and service time cut by 20%

Episcopal Hospital in Houston spent \$2.5 million on computers and a WiFi network for three of its 22 floors. Nurses and doctors bring laptops on their rounds, entering treatment info and zapping it to the hospital's intranet. Staff in the departments with wireless have cut data-entry time by 30%, says Gene Gretzer, the hospital's wireless project leader. The respiratory therapy group alone was able to shave staff by 20%, saving \$1.5 million while handling 13% more patients.

Increasingly, companies are using wireless devices that talk to each other, cutting out humans entirely. Thermo King Corp., which makes cooling units for trucks and shipping containers, is selling self-monitoring equipment. When a truck returns from a delivery, a radio connected to the Net contacts sensors on the vehicle that track the performance of the

from which parts were used, so when a technician stops in for supplies, replacements are waiting for pick-up. The payoff? Pepsi answers calls 20% faster than it used to and has saved \$7 million—meaning the project will pay for itself in just two years. And parts replenishment requests are now nearly 100% accurate, vs. 85% in the past, when legibility was a big issue. "We sell soda," says

Gary K. Wandschneider, senior vice-president for operations of Pepsi Bottling Group. "When we tried to figure out why customers switched to our competitors, part of the answer was customer service and equipment failure."

Field workers aren't the only ones going wireless. In warehouses, offices, and hospitals, wireless technology gives mobile workers instant access to data. St. Luke's

cooling machinery. If there's a problem, an alert is sent to a Web site monitored by technicians. That can mean savings of up to \$1,000 per truck annually by reducing spoilage and cutting maintenance staff.

Sure, the wireless Web hasn't lived up to expectations for consumers. For businesses though, the mobility of wireless combined with the wealth of data on the Internet are creating a one-two punch. ■

Where the Wireless Web Works

Businesses flocked to wireless projects as their cost fell by more than 50% in the past two years. Here's what companies are doing:

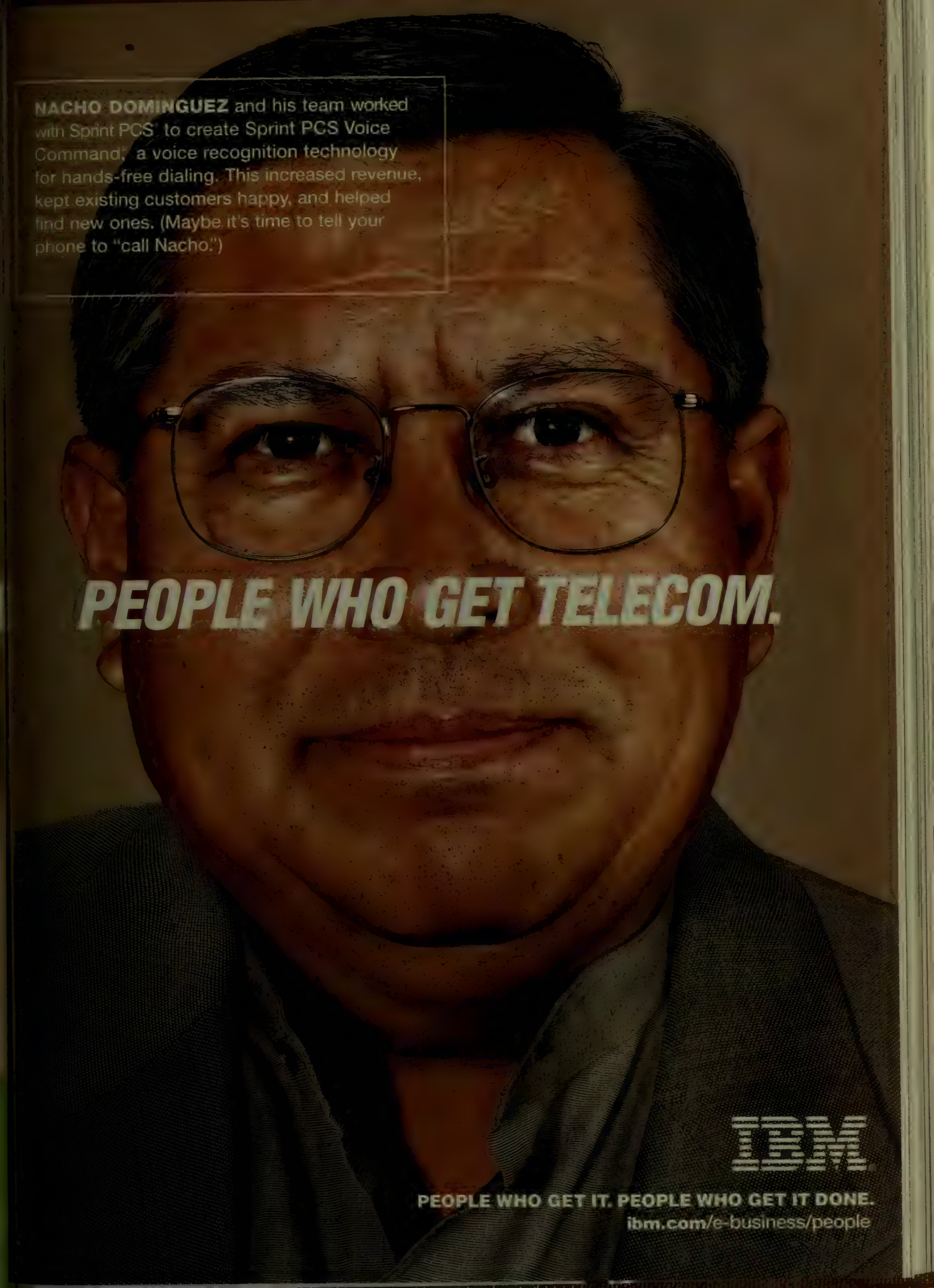
PROBLEM	PROJECT	PAYOFF	
Workers on the move: The roll-out of data networks helps companies improve customer service by getting info to reps more quickly.	Pepsi Bottling Group's 700 technicians phoned in to get service-call data—and faxed back billing info.	Now a wireless network sends details to the service rep's handheld. The device zips billing data to the office.	Service response time cut by 20%. Errors from the old fax system gone. Correct parts ready for pickup.
Wireless workplaces: Offices are setting up systems that transmit data from the Web or a company's intranet to employees moving about the workplace.	Staff at St. Luke's Episcopal Hospital in Houston spent too much time on administrative tasks. Handwritten records had potential for errors.	A wireless network for three of the hospital's floors lets staff check charts, lab results, and patient data, wiping out handwriting errors.	Staff on the networked floor cut time spent on data entry 30%. The respiratory therapy group cut staff by 20%, saving \$1.5 million a year.
Smart machines: Wireless devices in plants and warehouses can automatically collect data from other computers around them, speeding up work flow and eliminating paperwork.	Office Depot's 2,000 drivers sorted through info from 40-plus deliveries daily. This led to data-entry errors and slowed inventory tracking.	Drivers' handheld devices automatically transfer customer data to the company's Web site when they return each evening.	No more handwritten bills, which reduced customer complaints about missed deliveries by more than 10% last year.

Data: Gartner Inc., International Planning & Research, Cahners In-Stat Group, Venture Development Corp.



BEA FLORRY helped John Deere become
more efficient by developing an extranet that
enables 10,000 John Deere dealers to
track orders for parts via the Web.
Building this extranet reduced cycle time
and customer service costs by 30%.
Bea likes tractors. And tractors like Bea.

PEOPLE WHO GET MANUFACTURING



NACHO DOMINGUEZ and his team worked with Sprint PCS to create Sprint PCS Voice Command, a voice recognition technology for hands-free dialing. This increased revenue, kept existing customers happy, and helped find new ones. (Maybe it's time to tell your phone to "call Nacho.")

PEOPLE WHO GET TELECOM.

IBM

PEOPLE WHO GET IT. PEOPLE WHO GET IT DONE.
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The NEW Teamwork

This generation of collaboration technologies is making it easier for companies to work with partners and deliver products in record time

BY FAITH KEENAN AND SPENCER E. HALL

MARK THE TIME and place: Oct. 26, 2001, Lockheed Martin Aeronautics Co. in Fort Worth. On that day, the defense contractor won the first piece of the biggest manufacturing contract ever—\$200 billion to build a new family of supersonic stealth fighter planes for the Defense Dept. That Friday also marks the kickoff of a new

technology era, one that could transform the basic workings of every major corporation.

Lockheed's mega-win will require some intricate teamwork. More than 80 suppliers will be working at 187 locations to design and build components of the Joint Strike Fighter. It's up to the 75-member tech group at Lockheed's Aeronautics division to link them all together, as well as let the U.S. Air Force, Navy, and Marines, Britain's Defense Ministry, and eight other U.S. allies track progress and make changes midstream if necessary. All told, people sitting at more than 40,000 computers will be collaborating with each other to get the first plane in the air in just four years—the same amount of time it took to get the much simpler F-16 from contract to delivery in the 1970s.

A project this enormous requires a feat of computing to keep all its moving parts in sync. Lockheed and its partners will be using a system of 90 Web software tools to share designs, track the exchange

of documents, and keep an eye on progress against goals. Major partners such as Northrop Grumman Corp. already are hooked up. In about six months, the rest will be on board. "We're getting the best people, applying the best designs, from wherever we need them," says Mark Peden, vice-president for information sys-

tems at Lockheed Martin Aeronautics. "It's the true virtual connection."

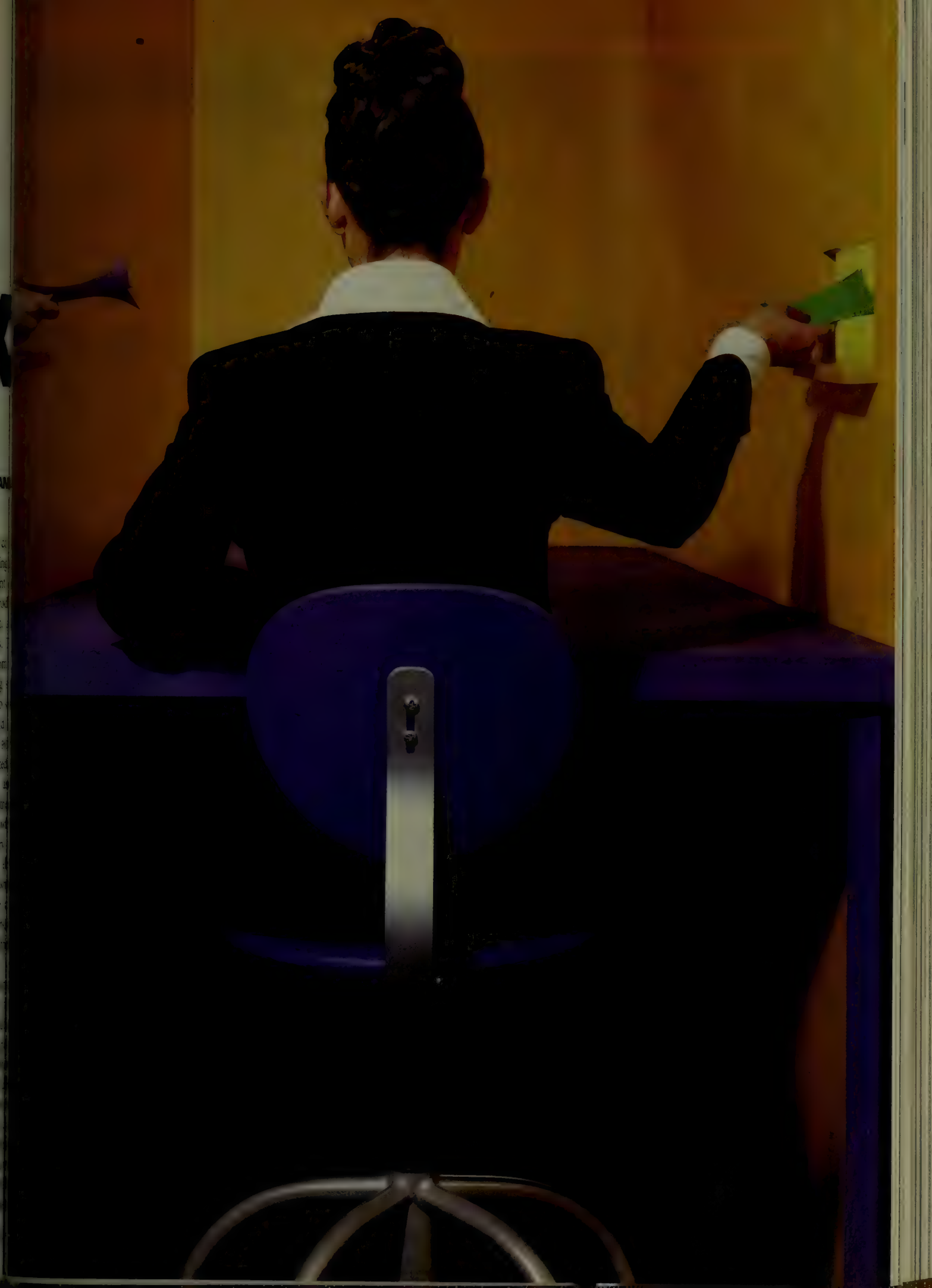
Management experts have long talked about the so-called virtual corporation: a company that focuses on what it does best and farms out the rest to specialists who can do it better. Now, a new generation of Net-collaboration technologies is making it easier for companies to work hand-in-hand with their partners to bring new products to the market in record time—and on penny-pinching budgets.

These jazzy new technologies could take the Web a step closer to delivering its potential. Companies can reinvent entire business processes, such as product design, supply-chain management, sales and distribution relationships. Net allows people from different companies with incompatible computing systems to meet in the middle on Web that speak a common language. And, instead of simply sending data from PC to PC, these Web tools let people separated by oceans interact with one another as if there were not even a wall between them. They can talk via their computers while looking at shared documents, carry-

ing out e-mail chats, and use electronic white boards—where two or more people can draw pictures or charts in real time, as the other watches and respond.

If this stuff takes off, the corporation we know it could be turned inside out. Picture it: Companies that have done everything in the past from ordering parts to bolting them together to selling them could instead use the Web as a giant electronic Yellow Pages—to find experts to do many of these jobs and then to collaborate with them over the Net on a minute-by-minute basis. The same company could offer its expertise to other firms, assembling and disbanding teams

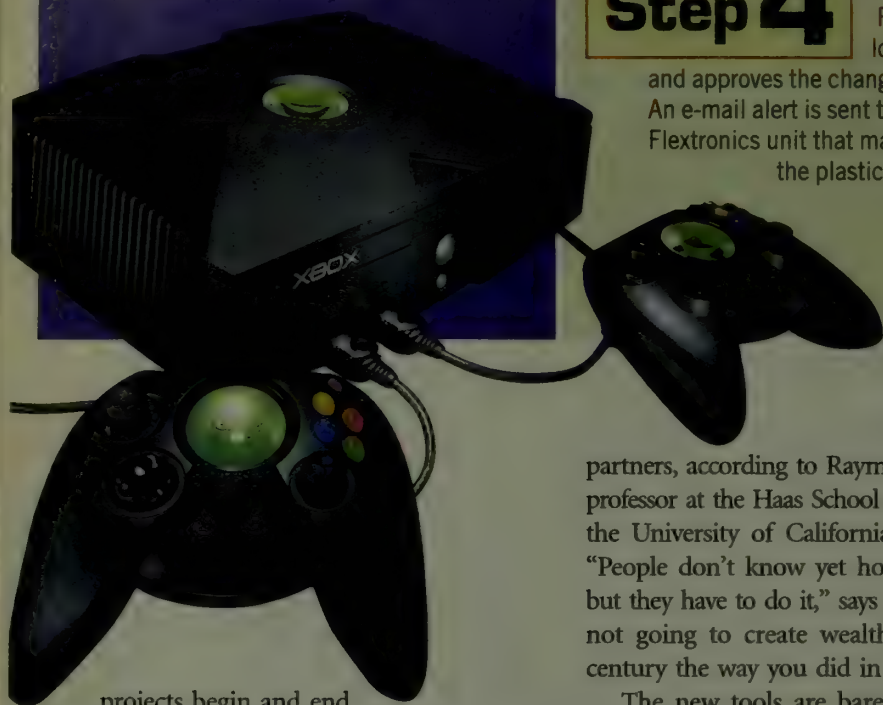
WEB-SOFTWARE TOOLS MAKE IT POSSIBLE TO REINVENT ENTIRE BUSINESS PROCESSES



Expediting the Xbox



Working with manufacturing partner Flextronics, Microsoft Corp. used a Web collaboration system to bring its new Xbox video game console to market last Nov. 15. The system helped slice about two months off the original production schedule. In one case, Microsoft decided that a metal bracket for holding the disk drive in place was too heavy, so it replaced it with a plastic one that was several ounces lighter and stronger.



projects begin and end.

Tighter relationships between companies also could spur innovation as they tap the best talent from anywhere in the world. Workers might end up identifying less with their company than with their cross-company team—and get bonuses based on the team's performance. Potentially more radical than reengineering, Web collaboration could reshape the traditional corporation, says George Colony, CEO of tech market researcher Forrester Research.

For now, most companies would be content with technologies that make them far more flexible and efficient. Previously, they mostly relied on a pricey older technology called electronic data interchange, or EDI, to trade basic information like purchase orders. Because of the limits of the technology and resistance to changing business processes, only about 10% of large companies are collaborating with

Step 1

Microsoft creates a 3-D design for the new part and, tapping into the system, tells Flextronics to make the change. The system automatically sends an e-mail alert to Flextronics' manufacturing and design teams.

Step 4

Flextronics logs on and approves the changes. An e-mail alert is sent to the Flextronics unit that makes the plastic part.

Step 2

Flextronics engineers log on to the system, see the change order, and discuss it among themselves. They determine that the change doesn't cause any problems with manufacturing.

Step 5

The parts people see the e-mail, log on to the system, and approve the change. The manufacturer modifies its tooling machines and builds a new version in two weeks.



partners, according to Raymond E. Miles, professor at the Haas School of Business at the University of California at Berkeley. "People don't know yet how to do this, but they have to do it," says Miles. "You're not going to create wealth in the 21st century the way you did in the 20th."

The new tools are barely out of the box, but some early experiments are showing solid results. By using the Web to coordinate auto design by internal engineers and external suppliers, General Motors Corp. can get a car into production in 18 months, down from the 42 months it took in the mid-1990s. Land O'Lakes Inc. has saved \$40,000 a month since September by using the Web to stuff butter and cheese into trucks it shares with companies such as Georgia-Pacific Corp. And Deloitte Consulting says it can bring a new team member up to speed on a project in a day or two, down from three weeks, by keeping everything they need to know on a Web site.

If this stuff delivers on its promise, it could help drive productivity growth for years. Yankee Group Research Inc. says that over the next five years, collaborating over the Net can save companies \$223 billion by cutting transaction, production,

and inventory costs. "There's an opportunity for a whole new level of business performance improvements in collaborative redesign of processes, using the Internet as the great enabler," James A. Champy, chairman of consulting at Perot Systems Corp. and author of *Engineering the Corporation: Reinventing Your Business in the Digital Age*.

Still, Net collaboration is only in its toddler phase. Network connections are always reliable, so real-time collaborative sessions sometimes cut off suddenly midstream. Technology novices tend to be flummoxed by logging on to Web sites and uploading documents. And even when the software works as advertised, it isn't always quickly adopted. Culture is the main hangup. Like squirrels burying nuts for winter, companies and their divisions have traditionally hoarded information—even from each other—for competitive advantage. The challenge is to come up with ways to reward employees for working in new ways.

Tight technology budgets also slowed adoption of new software. Many companies delayed collaboration projects in the second half of 2001. "They were going full-bore because they got burned before" by earlier Internet technologies that didn't deliver, says analyst Hea-

Step 3

soft makes a prototype of the part. It discovers the bracket isn't a perfect fit. It e-mails Flextronics with some proposed changes to the design.

Step 6

soft makes a prototype, approves it, and approves the part to go into production.



ellini of Salomon Smith Barney. "Next year is when we'll move beyond initial deployments. We're still very much in the early adopter phase."

Being a collaboration pioneer has paid off big-time for Juniper Networks Inc. It runs out operations like manufacturing, logistics, and customer support so it can concentrate on what it does best: designing and selling networking equipment.

Because the company is so efficient, even when revenue growth slowed to 32% in 2001 from a fivefold jump in 2000, it was able to increase research and development spending by 80%. "We were able to manage costs to protect strategic investment," says CEO Scott G. Kriens. "This is a lot to do with the outsourcing."

Juniper's network links its own operations with those of partners—setting off a digital chain reaction. Customers place an order via the Web, which relays the order to Juniper's core planning software, which spits out the details to every internal department that needs the info—from finance to supply chain and to outsiders like contract manufacturers. Juniper's production planning system automatically vets the manufacturer's inventory, raw materials, and production lead time—then

coughs up a date when the product will be shipped directly to the customer. If a customer changes her order on short notice, a team of material planners and process engineers from Juniper and its contractor manufacturers are alerted by e-mail. They get together in a Web conference to figure out what needs to be done to deliver on time.

One of the most effective uses of the new collaboration technologies is in the area of product development—everything from designing cars to developing new

prescription drugs. This kind of teamwork not only increases efficiency but boosts innovation—the holy grail of companies hoping to produce the Next Big Thing in their industry. General Motors, for one, has

chalked up big wins since setting up a collaborative engineering system in 1999 that allows GM employees and external auto parts suppliers to share product design information. Previously, GM had no way of coordinating its complex designs across its 14 engineering sites scattered across the world, plus the dozens of partners who design subsystems.

Now, GM's collaboration system serves as a centralized clearinghouse for all the design data. More than 16,000 designers and other workers use the new Web sys-

CHANGING OLD HABITS IS ONLY ONE OF THE ROADBLOCKS TO SMOOTHER COLLABORATION

tem from Electronic Data Systems Corp. to share 3-D designs and keep track of parts and subassemblies. The system automatically updates the master design when changes are finalized so everyone is on the same page. The result: GM has slashed the time it takes to complete a full mock-up of a car from 12 weeks to two. The time saved by online collaboration frees up workers to think more creatively—mocking up three or four more alternative designs per car.

After products roll off the assembly line, Web collaboration software can help sell them. Companies with complex sales channels are turning to the Net to help

sign up resellers and coordinate marketing. PTC, in Needham, Mass., which makes product-design software, is using Web-collaboration software to reach out to resellers it needs to expand to new markets not already served by its sales force. The software from ChannelWave Inc. automates the recruiting and certification process. It now takes a day to sign up a partner—down from a week. In a year, PTC has signed up about 170 partners. PTC expects to recoup the \$22,000 a month it pays for ChannelWave with an improved rate of converting leads for resellers to sales—35%, vs. 20% in the old days. It will be able to use the Web site to hand off leads to specific resellers and track their attempts to land customers. If a reseller is having trouble, PTC can step in to help cement the deal.

Once a sale is made, the next step is delivering products. Collaboration technologies are saving money in warehouses and on 18-wheelers. A dozen companies including Land O'Lakes and Georgia-Pacific use a collaboration system devised by Nistevo Corp., a software company in Eden Prairie, Minn., to use the fewest trucks possible and keep them full by matching loads and routes. The companies submit all the details about their routes and contracts with truckers to the Nistevo Web site. The company matches up the participants' schedules and notifies potential partners by e-mail. Once the companies agree to terms, they log on to a Web site to place an order for a truck and track the shipments.

The rewards are starting to roll in. In just six months, Georgia-Pacific says it has saved \$600,000 on one, six-legged route from Chicago to Maine and back again. And Fernando Palacios, vice-president for operations and supply chain at Land O'Lakes, says, based on initial results, the company expects to save a half-million dollars this year. Payoffs like that more than cover the average \$250,000 annual cost for Nistevo and the \$75,000 installation fee.

There's no matching Net collaboration when a crisis breaks out. Web sites can be set up in minutes. People are able to share data, schedule meetings, conduct forum discussions, and view up-to-date drafts of documents they're working on. Using a Web site provided by New York-

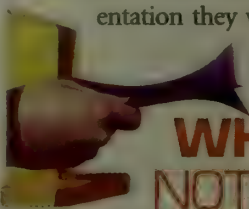
COVERSTORY

based IntraLinks Inc., 80 people from seven consulting firms produced a report for the New York City Partnership on the economic impact of the September 11 attacks. It took just six weeks—rather than the normal six months or more. The timing was crucial since the city needed facts to back up its pleas for relief funds. The Web site made sharing information a snap. Every morning, Jenny Abramson, an associate with Boston Consulting Group, posted links to newspaper articles on the Web site—alerting her colleagues with e-mails. “We were able to spend more time on the content issues, and less on logistics,” says Abramson.

Those are some of the best-case scenarios. In other cases, collaborative projects have yet to deliver the goods. Last spring, Baker & McKenzie, a Chicago law firm with 3,000 attorneys and 62 offices worldwide, was enthused about a new multimillion-dollar collaboration system from Lehi (Utah)-based Nextpage Inc. that would allow its lawyers to manage cases and corporate mergers with other parties over the Web. The company had an ambitious plan to roll out the service

to 10 of its offices in the second quarter and get the other offices online by the end of the year.

It didn't happen. The firm underestimated the training costs and the difficulties of changing peoples' behavior, especially among workers who weren't computer-savvy. During an early training session, one older lawyer actually confused a Microsoft PowerPoint presentation they were using to train



A KEY LESSON: IT'S PEOPLE WHO MUST WORK TOGETHER NOT JUST MACHINES

people for the collaboration service itself. “Getting people to practice in a different way is a very ambitious exercise,” says Mark Swords, a partner heading the initiative. Now, Swords says, Baker & McKenzie plans to roll out the service in the second quarter, a year later than expected, and in only two offices instead of 10 or more. The firm remains committed to it because he believes it could help land new clients.

Changing old habits is only one of the roadblocks to smoother collaboration. Technology bugs and a competitiveness are making people move gingerly. One tech manager at Boeing complains that Microsoft Corp.'s Meeting software for online meetings “is terrible.... Everything freezes so people have to reconnect.” Engineers complain about the time it takes to transfer big design files. And early users of a

laboration system made by Groove Networks Inc. in Cambridge, Mass., complain that they have to reformat Microsoft Word documents before they share them in cyberspace. Software companies are scurrying to work out bugs so their tools catch on faster.

One of the key early lessons is that for collaboration to work well, it has to be between people, not just machines. Management experts say digital workspaces can't completely replace traditional interactions, especially in the creative process. In-person communication is important for training, building relationships, and riding herd on a difficult project. Nistevivo addresses that by mixing tech wizardry with old-fashioned meetings. Palacios of Land O'Lakes, a company participating in Nistevivo's trucking project build trust and sort out their problems by meeting face-to-face every quarter.

Lockheed won't have the luxury of waiting for in-person confabs to get over hurdles. Its suppliers span 26 states and three countries. But it's willing to put up with the glitches that are inherent in electronic collaboration. The Lockheed team heading into the digital wilderness with the thought of turning tail. “This wasn't an accounting decision,” says Lockheed's den. “It was a what-do-you-want-to-when-you-grow-up decision.”

Other companies will face similar choices as these teamwork tools improve. For many outfits, finding a way to make collaboration work across corporate boundaries may be the surest path to reaching a ripe old age.

Contributing: Ben Elgin and Steve Har

New Ways to Get Work Done

Web sites where workers can collaborate change the game for corporations by saving time and money on everything from product design to mergers

BUSINESS PROCESS

Product Development: Companies are making products more cheaply and quickly by using the Web to synchronize the design process with suppliers.

Supply Chain: Companies can use shared Web sites to work closely with contract manufacturers and suppliers—reducing inventories.

Sales Channels: On Web sites, companies and their resellers share technical information, conduct employee training, and track sales leads.

Transportation: Logistics exchanges take the hassle out of delivering goods by offering quick price quotes, truck availability, and shared trucks.

Project Management: Law firms, consulting firms, and banks can use electronic bulletin boards to manage complex deals and projects.

PAYOFF

Using a collaborative system at 11 General Motors Corp. factories, the company has cut the time it takes to finish a vehicle mock-up from 12 weeks to two weeks.

By purchasing food ingredients and other goods via an online service that allows it to interact with suppliers, H.J. Heinz Co. has cut its supplier costs by 10%.

Toshiba Canada Office Products Group has reduced by half the time it takes to process orders handled by its resellers and has cut printing and mailing costs.

Georgia-Pacific Corp. has saved \$600,000, or 19%, since June on a single cross-country route that it shares with General Mills Inc.

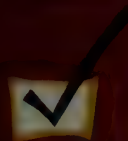
Deloitte Consulting can bring a new team member up to speed on a project within a day or two rather than the three weeks it used to take.



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Double Take

Ryan: "We are looking to acquire anything that is a...competitor."

IT HAS BEEN more than two years in the making, but DoubleClick Inc. finally seems poised to take advantage of one of the Internet's early promises: targeted marketing made possible by reams of information about customers' shopping habits. In 1999, DoubleClick paid \$1 billion in stock for direct-market researcher Abacus Direct Inc., which gathers information about the buying habits of

consumers from catalog sales and then sells it to retailers. DoubleClick hoped to merge Abacus' database of billions of consumer catalog transactions with its own data about shoppers' online behavior. But privacy advocates protested that would reveal too much about individual consumers, and DoubleClick was prevented from taking full advantage of Abacus.

Until now. On Jan. 22, DoubleClick rolled out a new service called ChannelView,

which helps retailers with online sales and catalog or store sales know how individual customers shop. With this information, retailers can target promotions to particular shoppers, find out whether the promotions are working, and quickly make adjustments. Consumers get to choose whether they participate or not, alleviating privacy concerns. "This is about taking advantage of what the Internet is good for," says Jupiter Media Metrix analyst Marissa Gluck.

DoubleClick's new service could have come at a better time for the company. Of all of the black eyes suffered by dot-coms, none has been worse than that of the online ad industry. After a blow of \$8.2 billion year in 2000, sales of Net ad plummeted 22%—to an estimated \$6 billion—last year, according to Merrill Lynch Inc. DoubleClick, the online advertising leader, took a licking with the rest. On Jan. 15, it reported that fourth quarter revenue fell 27%, to \$96 million, and it suffered a \$64 million loss.

Rather than become just another Internet hard luck story, the online ad pioneer is trying to prove that operating in a terrible market can actually be a good thing. The company is de-emphasizing its business of selling advertising space for Web sites. At the same time, it's

lick, WO

The online ad leader got hammered last year, but it's branching into new businesses and headed for profits

BY JEANETTE BROWN

ing in other ad-related businesses, giving up ads for Web sites from its computers, technology for analyzing customer data, and market research. Unless you see online advertising as dead, you really need to look at DoubleClick as a huge beneficiary of the shakeout on a long-term basis," says analyst Matt Kessler of Standard & Poor's.

In fact, most analysts expect online advertising to rebound, boosting all of DoubleClick's businesses. Merrill Lynch expects online ad sales to grow to \$7.3 billion this year, and bounce up to \$9.1 billion in 2003.

Already, the five-year-old company islobbering the rest of the industry it helped create. With 5,000 customers, DoubleClick is more than twice as big as its closest rival, 24/7 Real Media. Meanwhile, others are dropping by the wayside: MatchLogic Inc., once DoubleClick's primary competition, went out of business in mid-September. And rival Netcentives went belly-up on Oct. 9.

What keeps DoubleClick on top of the heap is cash. As a result of well-timed public offerings in 1998 and 2000, it has more than \$750 million. With a burn rate of \$10 million per quarter, the reserve could tide it over until it becomes profitable, which analysts expect by the third quarter of this year. And the cash allows DoubleClick to buy up the competition and distressed merchandise at a going-out-of-business sale. "We are looking to acquire anything that is a direct competitor," says DoubleClick CEO Kevin P. Ryan.

DoubleClick has acquired six companies or product lines in the past year. On Oct. 2, it bought a unit from former rival L90 Inc. that creates ads for Web sites and tracks the response to them. And on Jan. 18, it purchased e-mail

marketing outfit McAuliffe Message Media. Ryan expects several more acquisitions in the coming year.

At the same time, DoubleClick's ad-sales business is shrinking. The problem is that smaller Web sites are going out of business, and large Web sites increasingly handle their own ad sales, so there's a shrinking role for an intermediary between Web sites and advertisers. The company still handles ad sales for 715 Web sites, including Nasdaq.com. But the business is struggling. Fourth-quarter revenues for the unit were \$27 million, down from \$60 million a year ago, and more than 90% of the company's operating losses come from this business. DoubleClick says it's open to the possibility of exiting ad sales altogether if a buyer can be found—something analysts say is unlikely.

Even if DoubleClick doesn't shed the ad-sales business, a fundamental shift is

under way. In 2001, 50% of the company's revenues came from technology products and services, 32% came from ad sales, and 18% from market research. In 2002, the company expects technology to grow to 62% and ad sales to shrink to 16%, with the balance coming from market research. To boost its technology, the company has brought on a new chief technologist. Formerly CIO at Ameritrade, Mok Choe's mission is to develop new services for analyzing customer behavior.

It will take several quarters for the business remix to show results. Revenues will decline—from \$406 million in 2001 to \$369 million this year—before starting to grow again in 2003, say analysts. DoubleClick's stock is trading at about \$11 per share, up from a low of \$4.40 in October, because analysts are forecasting improved financial performance. Goldman, Sachs & Co. forecasts a \$5.36 million profit this year.

Expect DoubleClick's buying spree to go on until most of the valuable technology assets of the remaining online advertising companies are under its roof. Then, if the online ad market turns around, it will be ready for a second growth spurt. If this all works out as planned, the company's biggest problem might turn out to be an enviable one: dealing with the loneliness of being by itself on top of a still-emerging industry. ■

Getting DoubleClick to Click

With \$750 million in cash, DoubleClick is snapping up rivals and increasing the services it offers. Meanwhile, its core online ad-sales business is shrinking rapidly. Here's how the buying binge could help:

L90: The Oct. 2, 2001, acquisition of L90's online-ad serving and tracking unit lands DoubleClick 1,700 customers, for a total of 5,000—twice as many as its nearest rival. This is expected to help build the company's ad serving and tracking business to about 47% of overall revenues this year, up from 40% in 2001.

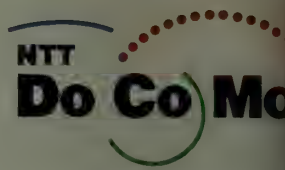
FloNetworks: Last April, DoubleClick bought FloNetworks for \$40 million, bolstering its push into e-mail marketing. The Web marketing business is expected to account for 15% of total revenues this year, up from 10% in 2001.

@plan: With the acquisition of the market-research company for \$91 million last February, DoubleClick set out to own a research arm. Combined with the company's business of selling info about consumers' buying habits, market research could grow this year to 22% of the company's revenues, up from 18% in 2001.

Data: Company reports, US Bancorp Piper Jaffray, SG Cowen Securities



Banking on i-mode for convenience in Japan.



Beyond The Mobile Frontier

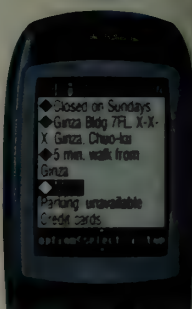
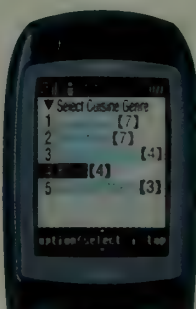
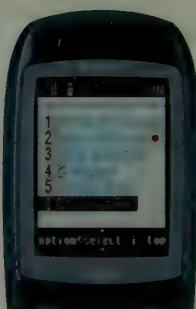
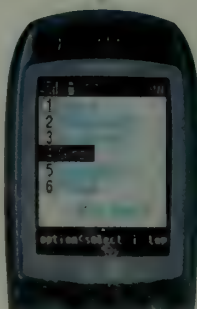


Cafe rendezvous in Tokyo

- Sorry I'm late.
- Yes, you're 20 minutes late.
- Am I that late?
- It's okay. So, what did you want to talk about?
- You know, I'm in charge of Yoko's after-wedding party. I thought this area would be good since it's close to the wedding venue. I wanted you to keep me company while I checked out some places.
- Then let's use i-area which will automatically give us information on restaurants, weather and even maps for where we are now and the surrounding area. From the i-menu, go to i-area. See? How about Ginza? It's got plenty of restaurant listings. Let's click on this place...
- Looks good. But why don't we first look at a couple of places ourselves?
- Well, we could just make the party reservation from this site with the "Phone to" function. But, yes, perhaps we should just go there and check the places out like you suggest.
- The large, clear screen makes it so easy to see the map.

But, aren't you worried about the phone bill? You've been connected for ages.

- No. It's a cost-effective packet communications system. So you only get charged by the amount of data you send and receive, not for the time spent online.
- Really? How convenient! Then if none of the places are any good, we can always do another search on i-mode.
- Sure. Before we get going, I'd like to suggest that we don't drink too much, OK?



NTT DoCoMo's i-mode service is only available to subscribers in Japan.

i-mode service was developed by NTT DoCoMo, one of the world's largest mobile communications operators. Within three years (as of January 2002), this remarkable service has attracted over 30 million subscribers in Japan of which over 10 million use Java™-compatible i-mode terminals with cost-effective packet communications services and access to a wealth of convenient content on the mobile Internet. In October 2001, NTT DoCoMo introduced fully commercialized "FOMA" 3G mobile communications, which now enables i-motion video-clip distribution services.

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MASTIES

ANOTHER TIME, ANOTHER ROSS PEROT

Perot Jr. dutifully runs the family computer biz, but Perot Jr. is blazing his own trail and making his own fortune

When you're H. Ross Perot Jr., the only son of you-know-who, it's tough to go against your father's wishes. As he says, "Rebelling wasn't a big option in my household. We never wanted to do anything that would make our parents embarrassed." After Perot Jr. graduated from Vanderbilt University in 1981, his father asked Texas developer Trammell Crow to give his son some career advice. Crow had just one word for young Perot: warehouses. Six years later, Ross

Jr. jumped into real estate development, using several thousand acres of his family's Texas land as the springboard. And when, in late 1999, his father began needling him to take over computer-services company Perot Systems Corp., he soon obliged: "I said, 'I'm here to do what you want me to do.'"

Of course, Perot *père* commands more attention than most other fathers. He helped launch the computer services industry when he founded Electronic Data Systems Corp. in 1962, and the company made him one of the richest men in America. He dazzled the country when he arranged for the daring rescue of two EDS employees held hostage in Iran in late 1979 and ran for President twice.

The way Perot *fils* looks at it, he would be crazy to strike out on his own:

"I was dealt some great cards, and I try to play them well," he says. Today, at 43, he is one of the most formidable developers in Texas. His firm, Hillwood

Development Corp., specializes in megaprojects requiring big backers, political muscle, and piles of public dollars. It's the kind of company that only someone with a name like Perot could run. Case in point: the \$420 million American Airlines Center in Dallas, which opened in July. Located on once-blighted land, it's the most expensive basketball and hockey arena ever built, and nearly a third of the funding came from tax receipts.

But now neither Perot's real estate ventures nor the family company are proving to be sure things. Recession has slowed the real estate market. And Perot Jr.'s reliance on public money, controversial in the best of times, is now being criticized even more harshly. That has put his scheme to surround the arena with an upscale urban streetscape in doubt. As CEO of Perot Systems, in which the family maintains a 32% stake, Perot Jr. is charged with

LORD OF THE RINK

Perot sold Dallas on the idea of a hockey and basketball arena

pulling off a tough turnaround during a brutal time for tech companies. Cost-cutting should help increase profits by about 15%, to \$65 million in 2001. And the stock has gone up 80% since he took charge in August, 2000. But the company is puny compared with such rivals as IBM and EDS, which Perot Sr. sold to General Motors in 1984 for \$2.5 billion. And it's growing at about half the rate of EDS. In the fourth quarter, revenues likely rose just 6.7%, compared with consensus estimates of 16.6% for EDS, says RBC Capital Markets analyst Cynthia L. Houlton. Annual revenues at Perot Systems were \$1.2 billion in 2001, she estimates; EDS sales were about \$22 billion. "They've got a ways to go," says Merrill Lynch & Co. analyst Stephen T. McClellan.

Just before Perot Jr. took over, the company fell into trouble. Perot Systems can still rely on contracts from health-care providers, which account for 39% of its revenue, but sales to other industries are faltering. In 2000, three major clients—UBS, ANC Rental, and East Midlands Electricity—greatly reduced their spending. The result: nearly \$200 million in lost revenue that caused sales to decline 3% for the year instead of growing an anticipated 14%. Analysts say a small player like Perot Systems needs to grow more than 20% a year, and for several years it did. But sales were slow in 2001 as well; the company expects to grow at least 15% this year.

Perot has replaced wayward execs and instilled new discipline in a company that some speculate had gotten away from his father. How? By reinforcing his father's maxims: Know your customer. Never be satisfied. Spend each dime like it's your own. "That's the way to get things done," says Perot Sr., who is the company's chairman but doesn't spend much time in the office these days. Replies the dutiful son: "I do anything he wants me to do." Many of the elder Perot's famously stern policies, including mandatory drug testing and no benefits for same-sex domestic partners, remain in place as well.

But the company still isn't quite measuring up. To speed its growth, Perot Jr. needs to broaden the company's skills far beyond serving health-care and financial-services outfits, probably by acquiring other firms. "They need many

more prospects," says McClellan. Perot admits as much: "We're certainly not satisfied today."

At least Perot knows a little something about toughing it out. He and his four younger sisters grew up with retired Marine Corps drill instructors as security guards. Perot Sr., a Naval Academy grad, used to tote his son to prisoner-of-war rallies and took him to Cambodia and Laos during the Vietnam War. When Perot Jr. entered Vanderbilt to study business administration, he eagerly joined the ROTC. After graduat-

H. ROSS PEROT JR.

BORN Nov. 7, 1958, Dallas

EDUCATION B.A., business administration, Vanderbilt University, 1981

CURRENT JOBS CEO, Perot Systems Corp.; Chairman, Hillwood Development Corp.

FIRST JOB Digging holes for shrubs at EDS campus, where his father, Ross Perot, was CEO

MILITARY SERVICE Joined the Air Force in 1983 and trained to be a fighter pilot; served 8½ years active duty and reserves

CLAIM TO FAME Co-pilot on first around-the-world helicopter flight; his aircraft, Spirit of Texas, hangs in the Smithsonian's Air & Space Museum

FAMILY Married to Sarah; they have four children



After circling the globe in 1982



Scouting out Dallas by helicopter

ing, he and a Vietnam vet at EDS, Jay Coburn, became the first to circle the globe in a helicopter, in 1982. Along the way, they had to make a treacherous refueling stop on a ship in the North Pacific. After that adventure, Perot served in the Air Force, then turned to real estate development in 1987. These days he wears the same uniform as his father: a suit, white shirt, and tie.

He has pretty much the same attitude, too. He intimidates other developers with an approach he calls "win or die." His vast assets, connections, and political influence help, too. Says one rival: "I don't like to compete with them head-to-head because you really can't. They can use their might." Perot is almost as rough on colleagues. For years, he fought with financier Thomas

O. Hicks, owner of Dallas' pro football team, over the arena's direction. They finally agreed to join forces, but it's not his vision that's guiding them now. Perots are "not used to being partners with somebody," Hicks says.

Perot Jr.'s first business challenge was convincing his father that he turn 2,500 acres of the family's pastureland into an industrial airfield surrounded by warehouses and factories. Then he wooed a host of public officials who over time put up \$152 million in public funds. Today, the privately held AllianceTexas spans 15,000 acres and is home to more than 100 companies as well as a NASCAR speedway. A research firm hired by Perot estimates the project is responsible for creating

every 15 jobs. Fort Worth and

That success paved the way for his next big idea: to revitalize downtown Dallas with a collection of the-art-of-the-palace surrounding shops, restaurants, and hotels. In 1998, he bought the NBA team, the Mavericks, and used leverage to as-

city to put up \$125 million, more than half the arena's initial price tag. Some money would come from an increase in taxes on hotel rooms and rental cars. Some balked at bankrolling the son of a billionaire. But, as he did with AllianceTexas, Perot employed a small army of lobbyists to sell the deal. In 1998, he narrowly won a referendum on the arena. Years later, he sold the Mavericks for \$280 million, doubling his investment.

But with the recession straining government budgets, Perot's ability to attract public funds may be diminished. Some city officials who supported the arena are resisting requests for an additional \$45 million in property tax receipts for more amenities. A coalition of Dallas property owners opposes the plan. They say it would siphon resources from other revitalization projects. If the city doesn't put up the funds, then Perot's main investors will walk away. As opponents are on the attack. Says Miller, a former city councilwoman and the leading contender for mayor in Feb. 16 runoff elections: "They are way too much. I cannot imagine we'll give them this kind of support again." The power of the Perot may be wearing off.

By Andrew Park in Dallas

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We absolutely, positively had to
have the system in 7 months..."**



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Chief Director, KPMG Consulting

FedEx

Corp



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Corporate Vice President, Strategic Financial Planning & Control,
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A LITTLE LESS IN THE ENVELOPE THIS WEEK

With companies cutting back, something's got to give—and in this downturn, it may be your pay package

A decade ago, the deal didn't get any better than at IBM. Big Blue's generous compensation packages offered medical coverage that was virtually free, cushy pensions, and salaries that rose dependably each year. Today, those guarantees are gone.

The convulsive change—in which IBM ripped out the ramparts of its entitlement culture and replaced them with more pay-for-performance and leaner benefits—began in the early 1990s and took on an added urgency during the late '90s war for talent. Cast as the crusty stalwart in the battle against all those cash-gorged startups coughing up options, IBM realized its compensation structure was about as appealing as its old Selectrics. A workaholic up-and-comer could exceed every goal and still wind up with the same raise as the incompetent in the next office. Worse, fewer than 1,000 employees had stock options. In a climate that was all about risk and reward, IBM was more about security and one-size-fits-all pay.

So the company instituted rigorous performance reviews, spread stock options to 70,000 workers, and made an average of 10% of employee pay variable—meaning it would swell and shrink depending on the worker's performance and that of the company. Benefits were also overhauled. In 1999, IBM announced

its new cash-balance pension plan, which saved the company millions but earned it the ire of employees, many of whom complained of losing as much as half of their benefits. That's not to mention health coverage, which ended up costing as much as \$157 a month. Says 37-year-old IBM engineer Jeff Zitz, who estimates his pension under the new plan could take as much as an 80% hit: "Halfway through my career, they changed the deal."

Now, blue- and white-collar employees across Corporate America are realizing just how much their deals have changed, too. Nowhere is the shift in risk more dramatic than at Enron Corp., where employees saw their retirement savings wiped out even as executives at the top cashed in.

But you don't have to work at a company that's bankrupt and under siege by federal investigators to feel at least some of the pain. In the first months of this year, for example, many workers at companies as diverse as Ford Motor Co. and Texas Instruments Inc. won't see a penny in bonuses—something that during the boom was a guaranteed slam-dunk, swelling pay by 10% to 70%. At Gap Inc., salaries are frozen, while at Bethlehem Steel and Wyndham Hotels, company matches to 401(k)s have been cut. At Lockheed Martin Corp., the squeeze comes in the form of soaring health-care costs: For some, the employee portion of premiums has tripled in the past seven years. Co-pays on doctor visits and prescription drugs have doubled. Robert M. Handshuh, a 45-year-old Lockheed Mar-

tin project manager, says his 2% won't begin to offset the spike, barely holding my own in the last years," he says.

Even in a recession, there is still big plus for workers in the new pay fluidity: It gives companies other besides layoffs to deal with the turbulence of the global market. The gain in variable pay and options is also reason why Federal Reserve Bank of New York economists Hamid M. and Joseph Tracy think the labor market is able to operate more efficiently than in the past: The new tools let companies an end run around wage deflation. Says Phil Webber, IBM's president of compensation and benefits, "Flexible compensation is good for

SHIFTING RISK

Employers are tying more pay to performance by using bonuses, stock options, and other variable-pay schemes—even as they reduce their contributions to benefits

MORE BONUS PAY...

SPENDING ON INCENTIVES TIED TO PERFORMANCE AS A PERCENT OF PAYROLL*



*FOR SALARIED EMPLOYEES, EXCLUDING OPTIONS
SURVEY OF 953 MID- AND LARGE-CAP COMPANIES IN A BROAD RANGE OF INDUSTRIES

...AND WIDENING USE OF OPTIONS...

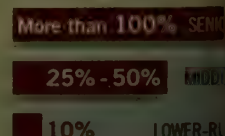
PERCENT OF COMPANIES WITH BROAD-BASED STOCK PLANS



Data: Hewitt Associates

...LINK MORE OF PAYCHECK TO...

OPTIONS AND VARIABLE PAY AS A PERCENT OF BASE SALARY, 2001



Data: Buck Consultants
William M. Mercer, Watson



ess in terms of controlling costs.”
 ing the boom, performance-based
 also enabled employees to pump
 their bank accounts by hitting goals,
 in turn helped companies boost
 activity.
 ll, it's hard to believe how fast—
 drastically—things have changed.
 eade ago, Corporate America prid-
 self on offering employees some
 ation from the vagaries of the
 ess cycle with a panoply of bene-
 nd a steady, if slow, climb in pay.
 handing out supersized raises to
 ete with startups during the boom
 l have wrecked profits and locked
 ce sheets into higher fixed costs.
 ompanies started doling out stock
 ns and implementing variable-pay

schemes—bonuses and
 other cash incentives
 that have to be re-
 earned each year. The
 gamble paid off as
 everyone from secre-
 taries to CEOs saw five years of dizzy-
 ing, double-digit gains in stock portfo-
 lios, lavish bonuses, and a sizzling job
 market that made it seem like person-
 al fortunes could only go in one direc-
 tion—up.

This year, employees are seeing the
 dark side of the deal: vanishing vari-
 able pay, tougher performance reviews,
 cuts to 401(k)s, and shrinking health
 benefits. A year ago, Silicon Valley sales
 and marketing executives like Madeleine
 Xavier were making more than six fig-
 ures. Today, Xavier,

a 36-year-old Univer-
 sity of California at
 Berkeley grad, works
 at online registration
 outfit Acteva.com—
 for a salary of noth-
 ing. Like many, she
 has taken a commis-
 sion-only sales job to
 tide herself over dur-
 ing the bust. “Now a
 company's attitude is

that you have to take a percent of the
 risk with them,” Xavier says. Adds He-
 witt Associates LLC compensation ex-
 pert Ken Abosch: “There's no question
 that most corporations have turned
 away from fixed forms of compensation
 in favor of variable forms. There has
 been an abandonment of entitlement
 programs.”

This quarter, for example, is turning
 into the bloodiest ever for bonuses.
 Salaries aren't immune, either. Nearly
 30% of companies have cut or frozen
 pay, says Steven E. Gross of compensa-
 tion consultant William M. Mercer
 Cos.—a number he projects could rise to
 50% this year if the economy stays
 weak. That's not to mention the over-
 whelming majority of employee stock
 options that are deep underwater.
 What's more, almost half of the compa-
 nies polled by Mercer, for example, said
 they plan on shifting greater portions of
 their health-care costs onto workers in
 the coming years. Kenneth R. Jacob-

ROBERT HANDSHUN

Lockheed Martin, project manager

His raises don't begin to offset the TRIPLING of his health insurance costs over the past seven years

sen, a consultant with benefits expert
 Segal Co., estimates that the percentage
 of an employee's paycheck going toward
 health care could spiral—in the worst-
 case scenario—to as much as 8.2% by
 2005, up from 3.4% today.

Mix in the grueling performance re-
 views, increased workloads, and insecur-
 ity over jobs, and it makes most pine
 for the gilded days—or at least look
 forward to the end of the New Econo-
 my's meanest season yet. The problem
 is, this may be more structural than
 seasonal. The workplace that's emerg-
 ing is a far different place from the
 office of the early 1990s. That's when
 most companies still subscribed to the
 peanut butter school of pay—spread
 the extra compensation thin but even-
 ly throughout the company. Bonuses
 and pay hikes were often given irre-
 spective of a weak economy.

Today, more than 75% of salaried
 and hourly workers have variable pay,
 up from fewer than half that number
 10 years ago. The number of companies

COMPANIES CHIP AWAY AT PENSIONS...

SPENDING PER HOUR
 IN 1979

\$1.13

\$0.96

\$0.74

AND HEALTH CARE

EMPLOYER SPENDING PER HOUR
 FOR HEALTH COVERAGE

'79 \$1.07

'89 \$1.35

'99 \$1.27

Data: Economic Policy Institute, Bureau of Labor Statistics

with pay-for-performance programs, some of which institute cutthroat quotas for "ranking and yanking" at least 5% of workers, also doubled in the 1990s. Moreover, more than 40% of companies now offer stock options to employees, up from just 8% in 1991. Compensation expert Gross estimates that in the late '90s, these awards amounted to as much as a 10% bump for low-level workers, 25% for managers, and more than 100% for senior executives (charts).

The boom-time bounty pushed nearly everyone up the ladder and made it easy for companies to get employees to buy in, especially since it masked some of the benefit takeaways. Now, though, the paycheck's volatility is leading to more uncertainty. Goldman, Sachs & Co. senior economist John Youngdahl estimates that the evaporation of variable pay alone, not including disappearing stock-option income, could subtract as much as \$40 billion in compensation in the first and second quarters—a sum that's more than last summer's tax rebates combined. He adds that people in the upper-income tier who are losing the most in variable pay are also the ones who have slashed their savings rate in the past six years.

True, recent tax cuts, mortgage refinancings, and dropping energy prices will help mitigate the effects. But hitching pay to the profits roller coaster could cause more aftershocks at the macro level. Morgan Stanley Dean Witter & Co. chief global economist Stephen S. Roach thinks that the plunging of variable pay in the first quarter could cause consumption to drop 0.8% instead of the consensus estimate of a 0.8% rise. Other possible dents in a recovery: dried-up severance packages, record levels of overall consumer debt, and the fact that laid-off workers typically get new jobs paying at least 10% less. "We are going to see incomes weaken considerably over the next three to six months," says Mark Zandi, Economy.com Inc.'s chief economist. "Even if the corporate top-line numbers are stronger, this is going to ensure that the recovery is muted."

Michael Rawson is one man whose usual contribution to consumer spending has disappeared this year. During



MICHAEL RAWSON

Ford Motor, production worker

Last year his bonus was \$10,000.

This year it's ZERO

company's other 100,000 production workers will take home a bonus of this March.

Still, it's not as if all employees serve to moan. During the 1990 survey after survey, workers said wanted more skin in the game, the opting for more measurements of performance. "We take risks, and can't whine when the economy south," says Intel Corp.'s director of consumer Internet strategy, David Nash, who, like Rawson, has seen his bonus shrivel to nothing this year. Many employees say they didn't realize that while they could be whipsawed by the ups and downs of variable pay, many executives would be insulated. At the same time that companies are cutting retirement benefits for employees, for example, some were also offering special supplemental plans for their highest-paid executives that guaranteed lush retirements.

For companies looking to preserve worker relations, September 11 is yet another complication. The attack created a slew of new corporate responsibilities to protect employees not only physically. But the crunching of budgets and benefits, coupled with the high-stakes performance assessments, send a mixed signal. They also create more inequality. Employers are using variable pay to lavish financial resources on their most prized employees, creating a kind of corporate star system.

No doubt, dismantling the old entitlement culture is bound to create a whole new set of questions. "How do you communicate to a workforce that isn't created equally?" asks Jay Schacter of Los Angeles-based compensation consultants Schuster-Zingheim & Associates Inc. "How do you treat a workforce in which everyone has a different deal?" One way companies start is by being clear about what the new deal is: Workers will have a greater chance to lap up the gains, but they'll also run a bigger risk of being left out in the cold.

By Michelle Conlin in New York with Robert Berner in Chicago

the boom, the production worker at Ford Motor did his share to give the economy a lift every March, when he got his annual cash bonus. Last year, it totaled \$10,000. Rawson socked away two-thirds into a retirement fund and used the rest to splurge on a 56-inch Sony TV. He was already counting on putting some of his 2001 money toward a souped-up hot tub, complete with an underwater chaise longue. "I would have gone out and bought it the next day," says Rawson, 46. But Ford's earnings have tanked, and he and the



MADELEINE XAVIER

Acteva, account executive

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(2.11b wireless LAN), Bluetooth™ wireless technology,
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transfers with other digital devices
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BIOTECHNOLOGY

WHERE IMCLONE WENT WRONG

What biotech—and Big Pharma—could learn from its debacle

How ever did it come to this? Since the Food & Drug Administration refused to accept an approval application for ImClone's promising new Erbitux cancer drug on Dec. 28, the company has been in something close to a free fall. Once one of the hottest biotech stars, ImClone Systems Inc. is grappling with a congressional investigation, Securities & Exchange Commission and Justice Dept. inquiries, and more than a dozen shareholder lawsuits. And now, ImClone development partner Bristol-Myers Squibb Co. is demanding that the company's founding brothers, CEO Samuel D. Waksal and COO Dr. Harlan W. Waksal, step aside. If they refuse, the pharma giant says it will walk away from its \$2 billion commitment to ImClone.

But Bristol-Myers CEO Peter R. Dolan has some explaining of his own to do, and so may the FDA. Sources close to the clinical trial say Bristol surely reviewed all communications between ImClone and the FDA, so it should have been aware of any problems. Yet both Bristol-Myers and ImClone insist they were stunned by the FDA's action. How that could be is one of the deep mysteries of this mess.

Clinical trials are often designed in close collaboration with the FDA, and the agency documents every conversation it has with company executives. Hundreds of pages of such memos have been filed with the congressional committee investigating ImClone. Erbitux' trial was in progress before ImClone approached the FDA, but the agency still had to review and sign

off on the design, which tested Erbitux on 120 very sick colon cancer patients in combination with standard chemotherapy. That's why congressional investigators are now asking how ImClone's appli-

cation could have been so out of with the FDA's requirements.

ImClone might take cold comfort the fact that it is not the first biotech company to run into trouble on FDA's doorstep. Over and over, drug approvals are delayed because the agency wants more data. In the past several months, Corixa, Chiron, Northfield Laboratories, Genzyme, and Genentech all had setbacks at the FDA with drugs trumpeted as promising. Several companies have announced delays in filing their FDA applications while tinkering with late-stage clinical trials.

All of these companies must constantly wrestle with reconciling the perdrive demands of a cash-hungry business and medical research that is slow and rarely definitive. It can take decades—and hundreds of millions of dollars—to develop a new drug. Most biotech companies, ImClone included, pin all their hopes on just one drug.

ImClone's fate is a cautionary tale for all biotech companies. They are regularly forced to go hat in hand to venture capitalists and the stock market to keep that drug in the running. In the background, there are desperately ill patients clamoring for effective treatments, adding to the urgency. "I think a lot of biotech companies get into survival mode instead of success mode,"

Richard B. Brewer

of Scios Inc. in Sunnyvale, Calif. ImClone's failure was delayed for a year and a half before the FDA unexpectedly approved it for more than a year. It finally approved in August. "I don't forget that the FDA is here to protect your drug," he says. "I don't want to see a cancer drug here to protect patients."

ImClone seems to have made all the classic mistakes of a biotech company hungry for a quick drug approval. It rushed through its FDA

Lesson No. 1:
Want to impress investors?
First, make sure your data will impress the FDA

HARLAN AND SAM WAKSAL

tion, kept clinical trials as small as reasonably possible to save money, and a board members renowned for scientific credentials—meant to impress investors—rather than their experience with the FDA. Only two of ImClone's directors came from the drug industry—former Ciba-Geigy U.S. chairman Richard Barth and former Bristol-Myers Vice-Chairman Sam R. Miller. ImClone's chairman, Bert F. Goldhammer, is a partner at a management firm Concord International Partners.

ImClone may have had another liability: its brash and boastful CEO. Sam Waksal, 53, has long raised eyebrows on Wall Street with his activities outside ImClone. He has dined with celebrities, hosted high-profile parties in his Soho loft, and has made large investments in restaurants. He and his brother borrowed more than \$33 million from ImClone in July 12 to raise options and warrants for 15 million shares. He has been a relentless promoter of Erbitux. Throughout last year, he assured investors that the drug would win a speedy FDA approval and be available by mid-

year, easy to understand and his hurried ImClone has turned a profit in its 17 years of existence. It has spent close to \$200 million and nine years developing Erbitux. His enthusiasm is understandable. Cancer specialists have been buzzing about Erbitux since 1999, the drug, combined with chemotherapy, showed notable efficacy against late-stage cancer. Granted, it isn't close to a cure. But it shrank in 22.5% of the participants in a 120-patient clinical trial, a high response for a cancer drug. Plus, to Erbitux has produced no notably debilitating side effects.

The FDA was impressed with the early data that prompted Erbitux fast-track status in February, 2001, and it would review the application within six months after

it was filed. ImClone executives promised investors that the application would be submitted by July, even though data from the 120-patient trial was only publicly released in May. That was an ambitious plan, since FDA applications are notoriously difficult to put together, typically requiring a truckload of verifying data.

Then came the first hint that the approval process would not be a smooth one. ImClone started filing its application on June 28. But it was a so-called rolling application, meaning sections would be submitted as they were completed. Ultimately, ImClone

Some doctors who participated in the clinical trials wish they could get the drug to patients



IMCLONE'S ERBITUX

did not complete its application until Nov. 1, setting off the FDA's own 45-day clock to decide if the application was adequate.

Meanwhile, ImClone had already won some validation on the business side. Sam Waksal announced in September that Bristol-Myers Squibb would buy a 20% stake in the company for \$1 billion. Shareholders got a windfall, since Bristol was paying \$70 a share, a \$20 premium over the trading price, just to get its hands on 40% of the marketing rights to Erbitux. Waksal and his brother Harlan together made \$111.3 million when they tendered 20% of their shares. Plus, Bristol promised \$1 billion more in payments to be parceled out every time ImClone met certain key milestones in the drug's development. One of these payments—\$300 million—would fall into ImClone's coffers as soon as the approval application was accepted by the FDA. Since the FDA rejects only a handful of such applications each year, ImClone likely felt the money was a lock.

But the FDA's 45-day deadline, Dec. 15, came and went with an ominous silence. When the agency announced on Dec. 28 that it would not accept ImClone's application, the boom fell—sort of. Sam Waksal insisted that the FDA's main concern was that the company did not include enough data on the disease status of the patients in the trial and that ImClone could easily provide that data. It was another clue that the application was rushed: Industry analysts say it is unusual not to include information on the status of each patient in a new-drug application.

ImClone still might have recovered its footing with the investment community—if the highly secret FDA letter spelling out the agency's objections hadn't been leaked. As reported in *The Cancer Letter*, an industry newsletter, the FDA said the clinical trial used to support the application was not adequate and that a new trial could be needed before the drug could be approved. Even more damning, it said the company had been

WHAT A DIFFERENCE A YEAR MAKES

The checkered journey of Erbitux, ImClone's cancer drug

FEB. 1, 2001 The FDA grants fast-track approval status to Erbitux.

MAY 12, 2001 ImClone reports a 22.5% response in the sickest colon cancer patients in clinical studies.

JUNE 28, 2001 ImClone starts filing a "rolling" approval application with the FDA, submitting sections as they are completed.

SEPT. 19, 2001 Bristol-Myers Squibb agrees to pay \$1 billion for a 20% stake in ImClone, plus \$1 billion in stages as Erbitux reaches approval.

OCT. 29, 2001 Bristol-Myers deal is completed. The Waksals tender 20% of their shares for \$110 million.

NOV. 1, 2001 ImClone finishes its application.

DEC. 6, 2001 COO Harlan Waksal files SEC document to sell 700,000 shares.

DEC. 15, 2001 An FDA committee reviewing the application extends its 45-day deadline to issue a decision.

DEC. 28, 2001 The FDA rejects the Erbitux application.

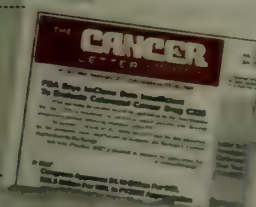
JAN. 7, 2002 An industry newsletter publishes parts of a leaked FDA letter, indicating that the agency had warned ImClone about the design of its clinical trials more than a year earlier.

JAN. 18, 2002 The same congressional subcommittee that is investigating Enron announces that it will investigate ImClone's conduct of its clinical trials of Erbitux. CEO Sam Waksal is forced to sell 80% of his ImClone shares in margin calls.

JAN. 25, 2002 ImClone receives inquiries from the SEC and the Justice Dept.



FDA HEAD-QUARTERS



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repeatedly about problems with its trial, even though Waksal had—and continues to say—that the company had no idea the trial would be ended inadequately.

he telling the truth? At least 12 shareholder lawsuits charge that he. The answer may be clearer once the company meets with the FDA in late February to determine how best to go

Bristol-Myers Squibb
may walk away
from \$1.2 billion,
the Waksals don't
put aside

DOLAN

ard. Right now, the FDA won't comment. Richard C. Mulligan, a genetics professor at Harvard Medical School and a member of ImClone's scientific advisory board, defends Waksal. "I find it inconceivable that there is any underlying deception," In-

gulligan, who was not involved in developing or testing Erbitux, says quite likely that there were errors in preparing the application. "Biotech executives say such errors are common, in part because FDA communications can be confusing to a company," Scios CEO Brewer notes that the company can easily change gears mid-stream—as it did with its company's biotech. After the drug was recommended for approval by the agency's scientific advisory committee, the FDA's reviewers rejected it and asked for new clinical trials that would test the drug's efficacy in head-to-head comparison with an existing treatment—done for drugs pre-approval. "You can say that's not fair or that's not what we told us in the first place, but they care about being fair," Brewer says. "They'll just say, 'things change'—they're right."

Doctors involved in the Erbitux trial were canvassed by *BusinessWeek* and they remain enthusiastic about the drug's potential and are disappointed the way things have changed. There is no doubt that the compound

works," says Dr. Robert J. Mayer, director of gastrointestinal oncology at Dana-Farber Cancer Institute in Boston, who has no financial stake in ImClone. "We have had people who benefited quite dramatically."

Mayer was an investigator in a trial of 57 patients who received Erbitux without chemotherapy, the results of which were also submitted to the FDA. About 11% of those patients responded, lower than the 22.5% response rate when Erbitux was combined with chemo but still considered good for a cancer drug in late-stage cancer patients. "The greatest frustration that people like me have is that there is a highly useful drug gathering dust in a back room due to the regulatory morass," says Mayer.



Bristol thinks it can pull Erbitux out of this morass, particularly if the Waksals get out of the way. Doctors investigating the drug say it is still the most promising compound around for colon cancer, a particularly deadly disease once it spreads. If more clinical trials are needed, there are plenty of patients eager to participate, they say, and trials could be completed by the end of the year.

Or, Bristol could base its FDA application on trials being conducted by the German company Merck, which holds the European rights to Erbitux. Merck is testing the drug against both head and neck cancer and colon cancer, and "the studies look good," says a spokesperson. It expects to present its results to the European Union by July or August. So biotech analysts are still confident that the drug will win FDA approval by mid-2003. Although AstraZeneca PLC has a similar drug, Iressa, in clinical trials that may arrive on the market first, that compound is being tested for lung cancer and may not be appropriate for colon cancer, doctors say.

Meanwhile, patients suffer. Dana-Farber's Mayer complains that "yes, the stock is down. Yes, there are unhappy people on multiple levels. But my concern is that this is an effective drug—and it is not getting to patients." He can only hope that Bristol-Myers does a better job the second time around.

By Catherine Arnst in New York, with John Carey in Washington and Jack Ewing in Frankfurt

Find out how the author invested \$2000 into \$250,000 in one year.

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During Lawrence H. Summers' days in the nation's capitol, the former U.S. Treasury Secretary earned a reputation as a prickly guy with an impolitic streak. Summers eventually learned to be more diplomatic, but he seems to have slipped back into his old habits since returning to Harvard University as its president last year. Indeed, after just one semester on the job, Summers already has managed to kick up more controversy than some of his predecessors did during their entire time in office.

Right off, he rattled students and professors alike by lambasting a grading system so generous that, last year, half the grades were A's, while 90% of the seniors graduated with honors. Then, after September 11, he assailed Harvard's long-standing antipathy toward the military, which is banned from campus. Most recently, he offended some of the university's high-profile scholars in Afro-American Studies, who promptly threatened to decamp to Princeton University after questioning his commitment to affirmative action.

Summers will need to resharpen his people skills in a hurry if he hopes to achieve even half of what he has set out to do at Harvard. You wouldn't know it from all the negative headlines, but ever since Summers took over last July, he has been methodically assembling an ambitious agenda to overhaul America's oldest university. Dramatic change is needed, he says, if Harvard is to retain its stature. Sure, the university's endowment has doubled in five years, to \$18.3 billion, making Harvard nearly twice as wealthy as its nearest rival, Yale University. Harvard's facilities, student body, and faculty—studded with Nobel



HARVARD

A dark, moody photograph of a person in silhouette standing on a path, looking towards a building in the background. The person is in the foreground, and the building is in the background, partially obscured by trees. The overall tone is somber and contemplative.

Larry Summers
has an ambitious
agenda to remake
the nation's
leading university.
Can he do it?

COVER STORY

HARVARD AND BEYOND

*If Summers succeeds
in putting more
emphasis on science
and multidisciplinary
studies, other
universities are likely
to follow his lead.*



LAW CLASS IN ACTION *Grad students get marquee professors, but undergraduates rarely interact*

laureates and other stars—also remain the envy of the academic world.

So how do you fix something that isn't broken? After an exhaustive inquiry, the 47-year-old Summers—himself a former Harvard economics wunderkind who won tenure at age 28—has come away convinced that his old school needs far more than a minor tune-up. His most shocking conclusion: Harvard College is failing to provide undergrads with the education they need in today's fast-changing global economy.

To rectify what he calls "Harvard's Achilles' heel," Summers is calling for nothing less than a cultural revolution on campus. He wants to stiffen grading, transform tenure reviews, encourage study abroad, and perhaps most important, persuade professors who now get rewarded almost entirely for their research to spend far more time with students. He also has initiated a review of the material undergraduates study that ultimately could help change the definition of a liberal arts education in the 21st century.

Summers' grand ambitions don't stop there. He wants to reassert Harvard's historic role in national policy, especially in education reform, where its president helped to set the national agenda in the 1950s by advocating large, comprehensive high schools. He even dreams of leveraging Harvard's growing prowess in medicine and the life sciences to help create a second Silicon Valley in the Cambridge-Boston area, built around biotech. Harvard has kept its preeminence over the centuries because "it has never been complacent or standing still," says Summers. "It has always been prepared to question the ways things have been done."

To accomplish all this, Summers wants to expand a campus that's already overcrowded. Even before he took over, Harvard had quietly purchased 100 acres in the Allston neighborhood of Boston, adjacent to

Harvard Business School—where it now has more land than it owns in Cambridge. Summers wants to move big chunks of the university across the Charles River to this site, which is the size of several Harvard Yards (map, page 76). The plan has rankled city officials and is opposed by Harvard law professors, who perceive the new site as an academic Siberia. Summers sees it as "an historic opportunity to create a Harvard campus for centuries to come."

A lot more than just Harvard's success is riding on Summers' big plans. Globalization and the technology revolution have wrought major changes in U.S. business and society in the past decade or so. Many educators worry that these trends aren't reflected in the education most college students get. "Summers comes to Harvard at a defining moment," says Columbia University's Teachers College President

SUMMERS' GRAND PLANS

Since former U.S. Treasury Secretary Larry Summers took over as Harvard's president last July, he has drawn up an ambitious program to overhaul the university. He wants to:

- ▶ Improve undergraduate education by stiffening grading, transforming tenure reviews, encouraging foreign study, and persuading professors to spend more time with students
- ▶ Reassert Harvard's historic role in national policy, especially in education reform, where it once set the national agenda
- ▶ Leverage Harvard's growing prowess in medicine and the life sciences to help create a second Silicon Valley in the Cambridge-Boston area built around biotech
- ▶ Build a new campus across the Charles River to accommodate the university's growth and his expansion plans

Arthur Levine. "His real assignment is to create a new kind of university to meet the needs of this very different society."

Indeed, even Harvard's archrivals hope Summers will succeed. "All of American education would be well served if Harvard devoted more attention to undergraduate education," says Yale President Richard C. Levin. Similarly, Charles M. Vest, president of Harvard's Cambridge-based competitor, Massachusetts Institute of Technology (MIT), says he's encouraged by Summers' interest in improving undergraduate science education. "For Harvard to stand up and make some bold moves in this area would set a wonderful standard for this country," he says.

The question, though, is whether Summers can overcome the formidable obstacles he faces. For all the prestige of Harvard's presidency, his powers are far more circumscribed than those of a Treasury Secretary, let alone a chief executive. Harvard has long given virtual autonomy to the deans of its 12 schools and colleges. In late 2000, for instance, Harvard Law School put the finishing touches on a 20-year strategic plan that calls for slashing class size while increasing faculty, programs, and facilities. Only then did Law Dean Robert C. Clark present a brief overview of the plan for approval to Harvard's governing corporation and Neil L. Rudenstine, Summers' predecessor.

Similarly, most of Harvard's endowment is assigned to specific schools, which jealously guard wealth. Harvard College and its grad school command \$8 billion, while the medical school has more than \$2 billion and the business school \$1.3 billion. Summers is left with control over less than one-fifth of the total. In this environment, he can hardly just order change. Instead, Summers will have to learn to curb his sometimes ranting manner and cajole these feudal lords to adopt his plan. Indeed, practically every plank in Summers' platform requires uprooting entrenched Harvard habits and interests. Given a faculty that is "narcissistic and self-serving," warns Sol Gittleman, the veteran provost of nearby Tufts University, the coming battles are "going to be tough."

To expand the campus, for instance, Summers must persuade some of

Harvard's schools to move from Cambridge to the new site in Boston. The law school is a natural candidate, since it's rapidly outgrowing its crowded, 17-acre campus. But Summers met a barrage of opposition when he broached the idea recently to law professors, who overwhelmingly voted against the move two years ago. Although Dean Clark worries that the law school will run out of space if it stays put, he says many professors fear that "if we build from scratch, we could end up with a Brasilia"—an isolated campus no one wants to go to.

In a similar vein, Summers' ideas for remaking undergraduate education cut deep philosophical rifts. For one thing, Harvard College Dean Harry R. Lewis pooh-poohs the issue of grade inflation. "The principal reason grades have been going up is that the student body is better," he says. Still, Summers is making progress. Harvard's faculty soon will debate a proposal to stop giving honors degrees to students with B averages.

Summers is hardly the first Harvard president to propose radical change—or face fierce resistance (table, page 77). When Harvard was founded as America's first college in 1636, it offered a medieval curriculum, imported from Britain's Cambridge University. By the time Charles W. Eliot took office in 1869, the Industrial Revolution had changed the world and "this classical curriculum was nearly useless," says Columbia's Levine. Despite opposition, Eliot reinvented Harvard as a modern university, replacing required classics with an elective system. Similarly, when James B. Conant took charge in 1933, he set out to make a meritocracy out of an elitist institution dominated by Boston's Brahmins. Conant's crusade met intense faculty opposition but nonetheless started Harvard down the road that led to today's dramatically more diverse student body (charts, page 76).

On paper at least, Summers is more qualified to lead than were many of his predecessors, whose experience was often strictly academic. After earning his BS from MIT in 1975, Summers quickly established a reputation as a whiz-kid grad student in Harvard's economics department. He was also a workaholic, says fellow grad student Kim B. Clark, now dean of Harvard Business School. In the late '70s, he and Summers established "one of the first 24-hour-a-day research operations" in economics, he recalls, with Clark beginning work about 5:30 a.m. while night owl Summers would "get going about noon and then go gangbusters into the early morning." In 1993, Summers received the John Bates Clark Medal, given every two years to an outstanding American economist under 40.

In fact, Harvard has never had a president with such prominent public-policy experience. In more than a decade in Washington, Summers served on the Council of Economic Advisers, as World Bank chief economist, and then, during the Clinton era, as Under Secretary of the Treasury for International Affairs before becoming Deputy Secretary in 1995 and Secretary in 1999.

But if Summers has a weakness, it's his combative, headstrong personality. "He likes a lot of give and take and can push people," says David Cutler, a Harvard economist who has known Summers since the mid-1980s. Cutler recalls conversations in which he suggested an idea only to have Summers quickly snap back "that he sees six or seven problems with what I suggested." It didn't bother Cutler, who says "that's just Larry's way of processing things." But it's a trait that landed Summers in hot water in Washington more than once.

In 1995, he irritated many on Capitol Hill when the Clinton Administration was desperately seeking congressional backing for a big bailout for Mexico. Summers, then Treasury Undersecretary, drew anger with his overbearing attitude and propensity to lecture

COVER



STORY

HARVARD

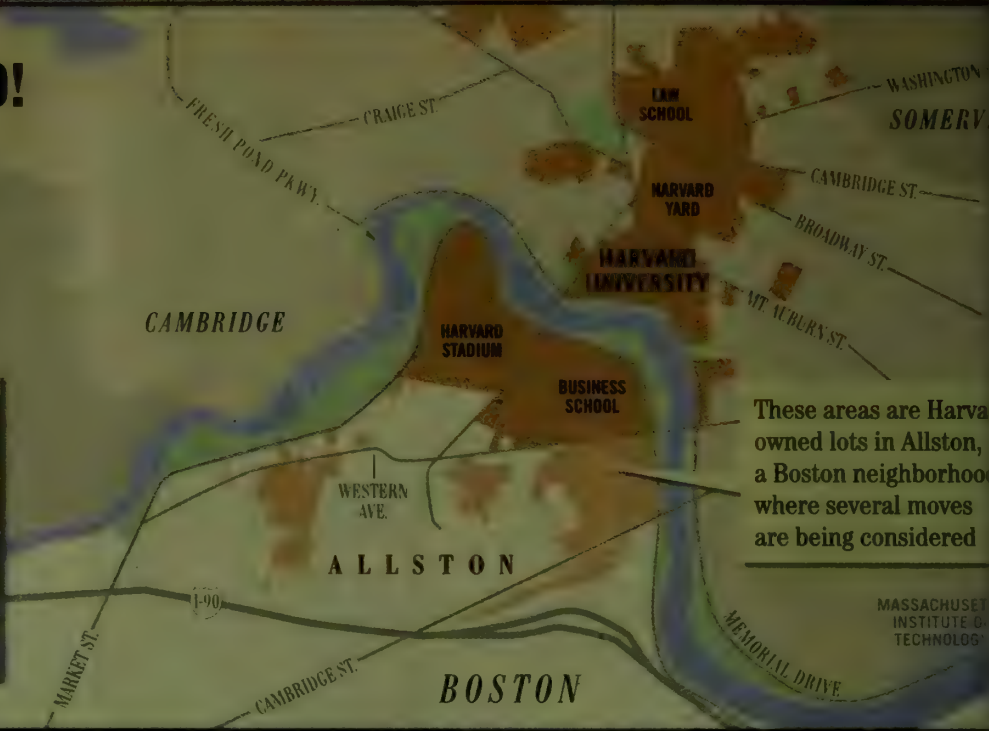
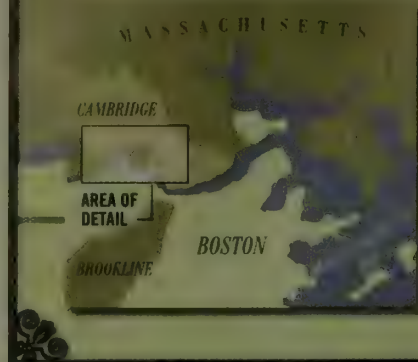


IN HIS ELEMENT

Summers on campus in 1988 and with President Clinton in '99

SOUTHWARD HO!

Harvard is running out of room, but Summers' proposal to expand across the Charles River from Cambridge to Boston is controversial



lawmakers. His high-handedness wasn't the only reason the effort failed, but it certainly didn't help. The Clinton team ended up sidestepping Congress and instead joining with the International Monetary Fund to rescue Mexico.

Summers got into hot water again in 1997 when he accused Republicans who wanted to cut estate taxes of "selfishness." His boss and mentor, then-Treasury Secretary Robert E. Rubin, quickly defused the situation, quipping that while he wasn't offended by Summers' remarks, his children were.

In fact, Summers learned a lot from Rubin, whose ability to handle people was widely admired. "[Summers] was a very different man after working with Rubin—more diplomatic and more effective," says former IMF deputy managing director and longtime Summers friend Stanley Fischer. "He does have an intellectually challenging style," adds Rubin. "[But] for a university like Harvard, that should be welcome."

The question is whether Summers can retain the lessons he learned in Washington. Consider the conflagration he ignited after an October meeting with Cornel West, who teaches Harvard's popular introductory course in Afro-American Studies. West later complained that Summers attacked him for cutting a rap CD and supporting the Presidential ambitions of the Rev. Al Sharpton. Summers calls it a "major misunderstanding." He says that while "diversity is crucial to [our] educational mission and academic freedom is sacro-

sanct...urging excellence in scholarship and dedicated teaching and the setting of high standards is central to academic leadership." Still, Summers failed to clear up the dilemma until after it exploded onto the front pages. On Jan. 1, one Harvard Afro-American Studies professor, K. Anthony Appiah, announced his departure for Princeton. While Appiah said he had no beef with Summers, the move could prompt West or other colleagues to follow.

Lost amid the furor is the number of allies Summers won over since taking office. "I am exceedingly pleased with his leadership," says Harvard Medical School Dean Joseph B. Martin. Adds Richard Zeckhauser, politics professor at Harvard's Kennedy School of Government: "When you lead a unit of 1,000 people may support what you do quietly while 50 oppose what you do vocally."

Certainly, Summers' plan to increase student contacts with professors has the support of many undergrads. On the day his appointment was announced last spring, Summers spent two hours in a meeting with some 50 undergraduate leaders. During the session, he asked: "How many of you have had a half-hour conversation with a senior faculty member about your future on an intellectual issue?" To Summers' chagrin, "less than half raised their hands," he recalls.

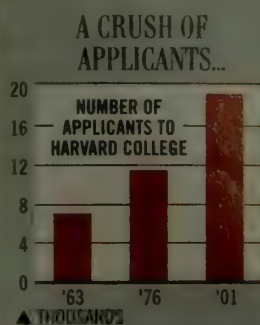
Of course, faculty neglect of undergrads is a long-standing problem at many major research universities. Harvard men typically take large survey courses, such as the

COVER

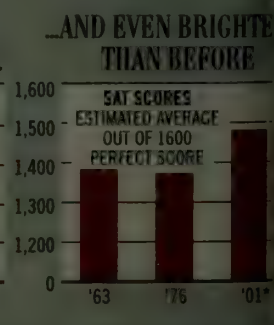
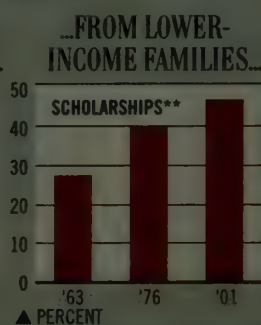
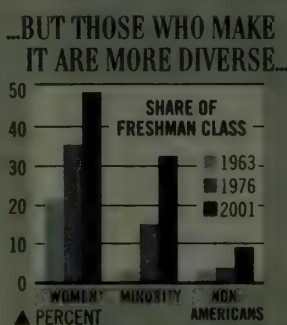
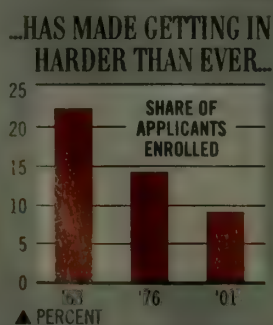


STORY

WHO GOES TO HARVARD



*PRIOR TO 1980, WOMEN WERE ADMITTED ONLY TO RADCLIFFE COLLEGE, A RELATED BUT SEPARATE INSTITUTION



SHARE OF STUDENTS RECEIVING NEED-BASED SCHOLARSHIPS FROM HARVARD *POST-RESCORING OF SATS

Data: Admissions Office, Harvard College

ry economics course taught by Martin Feldstein, the re-
ed economist. But with well over 500 students enrolled,
ever converse with the master. Instead, they interact
ly with graduate-student assistants. "A lot of people
lain they have had a very poor experience" with grad-
nt teachers, says Rohit Chopra, a sophomore who chairs
ard's student affairs committee.

mmers is launching a multi-pronged assault on the
s quo. To lift a student/teacher ratio that lags behind
of Harvard's rivals, he's expanding the arts-and-science
y to more than 700, vs. 642 today. He's also champi-
g teaching at every turn. It's a crusade that comes
ally to Summers, who as a professor made a point
ing available. "When I had a problem, he would
call me at 11 p.m. or come by on weekends,"
economist Cutler, who took courses from Sum-
as an undergrad.

ping to put money where his mouth is, Sum-
vows to change Harvard's internal reward sys-
The idea is to favor outstanding teachers when
prized administrative positions and in handing
ne university's most treasured award: tenured

At Harvard, the presi-
must sign off on tenure
ntments, and Summers
already rejected two
inent outsiders, both in
mid-50s. "The hiring de-
s at Harvard need to be
largely on predictions of
work rather than just
eward for extraordinary
achievement," he says.

at's more, with Harvard
to begin its biggest fac-
irring spree in a genera-
ne vows to make "teach-
valuations part of every
on." For that reason, he
ts to favor for tenure
ard's own assistant pro-
s, who are often by-
d in favor of outside lu-
ies. "People who come
rough our system tend
more oriented towards
ng," Summers says.

anwhile, the new presi-
is embarking on what
experts feel is a long-
ue review of undergrad-
curriculum. Like most
l arts colleges, Harvard
es students to choose a
r from one of some 40
lines. In addition, they
broaden their minds by
leting one course each
eight areas across the
ulum. But given an ex-
n of knowledge and the
ng importance of science,
iversities "need a new
of synthesis, a way of
ating the chaff from the
," argues former Brown
ersity President Vartan
rian, who now heads the
gie Corporation.

For starters, Summers wants to beef up what Harvard
traditionally has dismissed as "physics for poets"—science
education for nonscience majors. Today, Harvard has a "cul-
ture where it is unacceptable not to be able to name five
plays by Shakespeare but where it is fine to not know the
difference between a gene and chromosome," he complains.
"We have to find ways of making a basic understanding of
science a crucial part of what it means to be an educated
person," he says.

He's also pushing to encourage more study abroad. Harvard
has long made it difficult to get credit for study overseas, in
the belief that nothing matches a Harvard education. What
does exist is "half-assed," complains Chopra, the sophomore
who hopes to become an urban planner. Indeed, less
than 10% of Harvard students study abroad. In con-
trast, 21 Dartmouth College departments sponsor
overseas study and 47% of students take part.

Summers wants a more interdisciplinary approach
to learning as well. Currently, most students major
in traditional subjects, such as English or earth sci-
ences. But "as the nature of knowledge has
changed, many of the most exciting areas of in-

quiry cut across traditional dis-
ciplines," says Summers. So it's
increasingly important to com-
bine biology and computer sci-
ence, say, or politics and regional
studies.

The problem is, Harvard's fac-
ulty, not Summers, has the au-
thority to mandate a new cur-
riculum. So he must persuade
them to go along. In a university
where departments fight fiercely
for students and resources, "it
will be a hard assignment,"
warns Columbia's Levine.

Relocating whole portions of
the university to Allston could
prove equally challenging. Har-
vard got off on the wrong foot
with the city by buying up most
of its Allston land secretly be-
fore disclosing it as a fait accom-
pli a few years ago. Relations
have since improved. But some
city officials worry that gentrifi-
cation could destroy the blue-col-
lar neighborhood surrounding the
commercial land Harvard bought.
"I don't want to see families who
have lived in Allston for several
generations" pushed out, says
Mark Maloney, head of the
Boston Redevelopment Authority.

Then there's the question of
who at Harvard will get up-
rooted. Summers is mulling sev-
eral options. One is to move in
their entirety some of the
crowded professional schools,
such as education or law. A sec-
ond: relocate some of Harvard's
museums and administrative
offices. Third, Allston could be-
come a center for scientific re-
search, Harvard's fastest-grow-
ing academic activity. While
some in each group welcome the



BIG SHOES TO FILL

Summers joins an elite group of educators who each served long terms as Harvard's president



CHARLES W. ELIOT

TERM OF OFFICE 1869-1909.

PRIOR JOB Chemistry professor at MIT.

KEY ACCOMPLISHMENTS Replaced required courses at undergraduate level with electives. Opened Harvard Business School in 1908.



JAMES B. CONANT

TERM OF OFFICE 1933-1953.

PRIOR JOB Chemistry professor at Harvard.

KEY ACCOMPLISHMENTS Began shifting Harvard from a school for the Brahmin elite to a meritocracy. A major figure who championed creation of large, comprehensive high schools in late '50s.



NATHAN M. PUSEY

TERM OF OFFICE 1953-1971.

PRIOR JOB President of Lawrence College, liberal arts college in Appleton, Wisc.

KEY ACCOMPLISHMENTS Prodigious fund-raiser who expanded Harvard's faculty and buildings. Called in police during anti-Vietnam War protests.



DEREK C. BOK

TERM OF OFFICE 1971-1991.

PRIOR JOB Dean, Harvard Law School.

KEY ACCOMPLISHMENTS Expanded Kennedy School of Government. Championed affirmative action to diversify Harvard's student body.



NEIL L. RUDENSTINE

TERM OF OFFICE 1991-2001.

PRIOR JOB Executive V-P, Mellon Foundation.

KEY ACCOMPLISHMENTS Dramatically in-creased endowment. Merged Radcliffe Col-lege—Harvard's former women's college—into Harvard.

Data: *Making Harvard Modern*, by Morton Keller and Phyllis Keller

added space, opponents fret about lost power and prestige.

Summers' biotech dream is one argument for expanding science across the river. In recent years, Harvard has set up the Institute for Chemistry & Cell Biology and the Institute for Proteomics, the study of proteins, to push biomedical research. And the Medical School has launched its largest expansion ever with the same aim.

The result, Summers argues, is an historic opening if Harvard can seize it. MIT, Harvard, and its affiliated hospitals already have attracted biotech companies such as Biogen, Millennium, and Vertex. They could serve as the springboard for more industrial development. "Where high tech is only moderately driven by academics, biotech is completely driven by it," says Chris Gabrieli, a partner at Everest Ventures, a biotech venture-capital firm. He sees a seamless flow in which

COVER



STORY

cures are developed at Harvard or MIT, test Harvard's teaching hospitals, and spawn companies. But to make that happen, Harvard break from its pure-science past and move closer to MIT's philosophy of working closely with companies—a big cultural change.

Plenty of Summers' constituents at Harvard port some or even much of what he's trying to achieve. But acting like a hotshot academic says whatever comes into his rapid-fire mind could find him banging his head against the Georgian brick building of Harvard Yard. If he can learn how to truly lead, Harvard could be transformed into an even better institution than already is. In the process, it might also set an example for American universities would want to follow.

By William C. Symonds in Boston
with Rich Miller in Washington

'I'M HAVING A GREAT TIME'

Harvard's new president has challenged seemingly every policy and practice on campus. In a recent interview, Larry Summers discussed his views with Boston Bureau Chief Bill Symonds.

Grade inflation is rampant at Harvard. Some 90% of all students now graduate with honors. Should they?

Standard-setting is integral to education, and grading is integral to standard-setting. What grades and honors represent is [that an honors student] is the best relative to a peer group at a point in time. People run much faster than they used to, but we still give only one gold medal.

You argue that Harvard must do a better job of teaching science to non-science majors. Why?

If war is too important to be left to generals, science and its implications are too important to leave to scientists.... In an increasingly technical era, we are going to have to find ways of making a basic understanding of science...a crucial part of what it means to be an educated person.

You have also criticized Harvard's long-standing reluctance to let students study abroad.

We need to recognize that much of what is important in education doesn't take place in the classroom.... In light of the importance of globalization, we should...promote many more students going overseas.

What is the biggest problem with the way you educate undergraduates?

HARVARD'S DEEP POCKETS

(Universities with the largest endowments in fiscal 2001)

University	Billions
HARVARD	\$18.3
YALE	10.7
UNIV. OF TEXAS	9.4
PRINCETON	8.4
STANFORD	8.2
MIT	6.1
UNIV. OF CALIFORNIA	4.7
EMORY	4.3
COLUMBIA	4.3
TEXAS A&M	4.0

Data: National Association of College & University Business Officers

If there is an Achilles' heel in the Harvard experience, it is with respect to faculty-student contact.... There are still too many students who are able to graduate without having direct personal contact with faculty members.

You recently vetoed two academic stars in their 50s who had been nominated for tenure. What are you looking for?

In the next decade, we're likely to see more faculty hiring than in any decade in at least a

generation. I want to shift towards recruiting scholars more on the basis of their future promise...what they will contribute when they are here rather than just being able to point to people like trophies on a wall and say, "We have X"—but X didn't do it here.

What about financial aid for graduate students?

Any student can come to Harvard College [regardless of financial re-

sources], but that is not true today at [the graduate level]. Perhaps the most important thing we can do is make it possible for students who want to go into public service [to get sufficient financial aid] so they won't be constrained [by lack of money]. This will mean mobilizing funds on a university-wide basis.

How are you going to pay for everything you want to do?

We're going to use our resources as aggressively as possible. That means we are...prepared to cut things where appropriate and to spend more aggressively from the endowment.... Harvard is much bigger than Princeton, but if you just look at the Faculty of Arts & Sciences, Princeton has about 40% more money than Harvard. So this idea that Harvard is uniquely rich in higher education is just not true.

How do you like your new job?

I'm having a great time.... What is exciting is that so much [of what I do now] is not about tomorrow or the day after but about things that will have influence over a long time. ■



ODAY

TOMORROW

TOYOTA

mass-produce a hybrid
system that reduces
smog-forming emissions
by up to 90%.

The other 10%



In 1997, Toyota was the first car company in the world to mass-produce a hybrid vehicle. By combining gasoline and electric power, the Prius reduces smog-forming emissions*, cuts gas consumption in half, and, in short, has revolutionized the way cars affect our environment.

Even so, we're not resting on our laurels. The Toyota Hybrid System is being further refined, to make it cleaner and more efficient. And we're continuing to search for even greener forms of transportation.

Our hydrogen-powered fuel cell hybrid SUV is now being road-tested. Its only emission is pure water. Beyond that, who knows. But no matter what alternatives are discovered in the future, they won't be found overnight. They'll be the result of 90% perspiration. And 10% inspiration.

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COLIN TSAI AND LENA
AND YULIA OF TATU



MTV'S WORLD

he Suit vs. the Tattoo Set. Fog-
Bottom and the Hip Hop Crowd.
General and the Veejay. It's,
...well, it's another weird but fas-
g cultural moment on MTV, the
-owned music network that sup-
ports its core mission of delivering
fibel music to the world's teens
straight-talking programs on is-
such as AIDS, drugs, and racism.
p. 14, U.S. Secretary of State
L. Powell will lead *Be Heard*, a
s-barred talk show on MTV Net-
where he will field questions on the crisis in Afghanistan
ens from Boston to Berlin to Bombay. The program will
MTV's 33 channels worldwide and reach almost 375 mil-
households. MTV's video jockeys—the ones who usually de-
all-to-wall Hindi film music, German hard rock, Mando-
ed Mexican hip hop to local viewers—will moderate the
g, and translators will be on hand to turn questions into
It will be, in other words, an Event.
ell's appearance is a media moment that only MTV
ull off. Media moguls can babble on about the global

Mando-Pop. Mexican Hip Hop. Russian Rap. It's all fueling the biggest global channel

village, about how CNN or BBC can
reach out and touch the world. But
those news shows are bush league op-
erations compared with MTV's clout.
Thanks to the roaring success of its
subsidiary, MTV Networks Internation-
al, the music channel and its sister op-
erations, VH1 and Nickelodeon, reach
1 billion people in 18 different lan-
guages in 164 countries. Eight out of
ten MTV viewers live outside the U.S.
CNN reaches an international audience
less than half the size of MTV's. Its im-

pressive global reach has earned MTV membership in that elite
of such globally transcendent brands as Coke and Levi's.

MTV seems not to have missed a beat as turmoil roils the ex-
ecutive ranks at parent Viacom, whose board in late January
called upon CEO Sumner Redstone and Chief Operating Officer
Mel Karmazin to cease feuding. The stock is down almost 20%
since early January, but analysts say the strife should have no
impact on operating units like MTV. MTV Networks International
makes buckets of money year after year from a potent com-
bination of cable subscriber fees, advertising, and increasing-



On the Move

NORTH AMERICA

HOUSEHOLDS REACHED	84.6 million
CHANNELS	6
WEB SITES	2
LANGUAGES	2
HOTTEST MARKET/REVENUE GROWTH	United States/5%
ARTIST TO WATCH	Jennifer Lopez

LATIN AMERICA

HOUSEHOLDS REACHED	28.1 million
CHANNELS	4
WEB SITES	2
LANGUAGES	2
HOTTEST MARKET/REVENUE GROWTH	Mexico/27%
ARTIST TO WATCH	Alejandro Sanz

EUROPE

HOUSEHOLDS REACHED	124.1 million
CHANNELS	15
WEB SITES	9
LANGUAGES	7
HOTTEST MARKET/REVENUE GROWTH	Russia/80%
ARTIST TO WATCH	Alsou

ASIA / PACIFIC

HOUSEHOLDS REACHED	137.9 million
CHANNELS	8
WEB SITES	6
LANGUAGES	8
HOTTEST MARKET/REVENUE GROWTH	China/80%
ARTIST TO WATCH	Na Ying

Data: Viacom Inc.

MTV's policy of 70%

Networks International and, theoretically, is based in London. Theoretically, since his real office is more of a perpetual airborne state involving him, his trademark army pen and paper, and a business-class round-trip ticket to wherever. To give kids their dose of rock, he has breakfasted with former Israeli Prime Minister Shimon Peres, dined with Singapore founder Lee Kuan Yew, and chewed the fat with Chinese leader Jiang Zemin. Roedy even met with El Comandante himself—Cuban leader Fidel Castro, who wondered how he could teach Cuban kids English. Says Roedy: "We've met very little resistance once we explain that we're not in the business of exporting American culture."

Roedy & Co. are shrewd enough to realize that while the world's teens want American music, they really want local stuff, too. So, MTV's producers and veejays scour the local markets for the top talent. The result is an endless stream of overnight sensations that keep MTV's global offerings fresh. Just over a year ago, for example, Lena Katina and Yulia Volkova were no different than most Moscow schoolgirls. Today, Katina, 16, and Volkova, 15, make up one of the hottest bands ever to come out of Russia. Tatu won a cult following among local teens since their debut single, *Ya Soshla s Uma (I've Gone Crazy)*, first aired on MTV Russia 15 months ago. Universal even plans to promote Tatu's next recordings in the U.S. "Our producers have signed a contract with Sony or Warner, too. We have offers from all of them," says Katina.

Tatu is just one of a slew of emerging local music acts gaining international exposure through MTV and a wider audience in the U.S., too. Colombian rock singer Shakira, known outside Latin America until she recorded an MTV-plugged CD—the acoustic live concerts recorded by MTV in 1999, is now the winner of one U.S. Grammy and two Latin Grammy awards. Her CD has gone platinum, selling more than 2 million copies worldwide. After releasing four CDs in three years, Taiwanese pop star Jolin Tsai, 21, is gaining popularity in mainland China thanks to heavy airplay on MTV.

ly, new media. Few other transnational media operations can claim to make profits at all. But revenues at MTV Networks International increased 19% in 2001, to \$600 million, while operating profits grew a hefty 50%, to \$135 million. They are expected to more than double by 2004, according to Merrill Lynch & Co. media analyst Jessica Reif Cohen. In the past three years, the growth of MTV Networks International has outpaced the domestic network, accounting for 16% of MTV Networks' revenues, says co-founder and Chairman Tom Freston. He aims to increase that to 40% within five years, as MTV in the U.S. starts to plateau. MTV's international success

is attracting a host of imitators, one of them spawned by the relentless Rupert Murdoch.

But for now, MTV's version of globalization rocks.

MTV Networks International owes its success to a lot of factors. First, demographics: There were 2.7 billion people between the ages of 10 and 34 in 2000. By 2010, there will be 2.8 billion. Increasingly, this age group is acquiring the bucks to buy CDs, jeans, acne cream—whatever brands are hot in each country. That means advertisers increasingly love MTV International. Second, music: All that stuff about music being a universal language is true, and rock is the universal language for Planet Teen. What MTV does is customize the offering in a brilliant way. Third, television: The number of sets in the world's living rooms—especially in such places as China, Brazil, Russia, and India—is exploding. So are the globe's cable networks. "Everyone who has a TV knows there's something called MTV," says Chantara Kapahi, a 17-year-old student at Jai Hind College in Bombay. The fourth reason: Bill Roedy.

Roedy, a 53-year-old West Point grad, is president of MTV

Entertainment



ent has been the source of its most creative shows

Viacom is now counting on MTV to be one of its biggest growth drivers in the next decade. There's plenty of room to launch new channels on cable and satellite outside the U.S., where penetration, at 38%, is about where the American market was in 1983. As digital television takes off in Europe, Viacom plans to introduce more music channels, such as the seven it has in Britain that focus on such genres as rhythm-and-blues and dance. Another part of the strategy: make MTV "a vehicle to develop business [for other Viacom brands]," says Viacom COO Karmazin. "Let's face it, the way people know Viacom is through MTV." Viacom can parlay growth abroad for its better-known VH1, Nickelodeon, and TV Land brands "off MTV's station."

MTV also is betting heavily on emerging technologies. In Scandinavia, it recently premiered MTV Live, which goes to market with broadband cable. Viewers can play virtual games, such as *Trash Your Hotel Room*, where users get the chance to be a rock star and wreak virtual havoc. Meanwhile, in July, MTV Asia launched LiLi, a virtual animated veejay who interacts with viewers on air and online in five Asian languages. The actor behind the image controls the character's responses, letting her interview artists and offer viewers tips on pop culture in real time. LiLi is so popular with Asian teens that Ericsson has launched a line of mobile phones. In Japan, an wireless Internet service lets users download entertainment videos, vote for their favorite veejays, or choose music. MTV "tries to make a lot of noise off the channel," says Nigel Robbins, CEO of MTV Group Japan.

MTV's early international expansion—it got into Moscow in 1993,

for example—puts it ahead of the competition in nearly every market. Hong Kong-based Channel V's 24-hour music channel, owned by Rupert Murdoch's Star TV, reaches nearly 47 million homes but has yet to make a profit. VIVA—owned 45.9% by AOL Time Warner, EMI, and Vivendi Universal—is MTV's biggest rival in Europe. It reported a net loss of \$9.4 million on sales of \$40 million in the first nine months of 2001 but expects to be in the black in 2002. "The market is big enough for both of us," says VIVA CEO Dieter Gorny.

MTV faces some risks in a handful of countries, such as Italy and Brazil, where it operates with a local partner. "It's really a question of whether they can maintain distribution on outlets they don't own," says Sanford C. Bernstein & Co. media analyst Tom Wolzien. Wolzien says News Corp. and Vivendi have much stronger relations with local regulators, giving them an edge in launching music channels they can control.

MTV's best response to these threats is to make its programming as strong as possible. Its policy of 70% local content has resulted in some of the network's most creative shows, such

as MTV Brasil's monthlong *Rockgol*, a soccer championship that pits Brazilian musicians against record industry executives. In Russia, the locally produced *Twelve Angry Viewers* was voted one of Russia's top three talk programs. In a colorful studio amid bright blue steps and large green cushions, a dozen teens watch and discuss the latest videos. Periodically, they break into spontaneous dance or pop one another over the head with inflatable lollipops. O.K., it's not Chekhov. But Russian groups beg to be featured on it. Says producer Piotr Shekshyev: "MTV trusts that we Russians know best what works."

Ceding so much control to local





MTV's Chinese ad income almost doubled in 20

channels does result in the occasional misstep. While watching MTV in Taiwan, Roedy was aghast to see nude wrestling.

That was one time he had to intervene. When MTV first entered the Indian market in 1996, Hindi film music—the romantic soundtracks of Bollywood movies—was wildly popular, but the channel's locally hired programmers disdained it as uncool. Viewers abandoned the channel, forcing it to air Bollywood music. Since then its ratings have soared by some 700%.

India is one of the giant markets that MTV is determined to dominate. The other big-country play is China. Analysts believe it is likely to be some time before the government grants 24-hour broadcasting licenses to foreigners on a nationwide basis. Still, in 2001, MTV's advertising revenue in China almost doubled—even though the network airs only a maximum of six hours daily through Chinese cable systems.

Roedy has spent the past decade cultivating relationships in China. At one long dinner with Chinese operators, he desperately attempted to hold his own through countless toasts and karaoke songs. After his Chinese terparts sang Chinese opera arias, Roedy sang a few from *Madame Butterfly*, while MTV Chairman Freston ed out *House of the Rising Sun*, the bluesy ballad a New Orleans whorehouse. They must have been in MTV Mandarin is seen in 60 million homes in China via Chinese cable systems. Last year, more than 10,000 came from all over China to audition to become the veejay on MTV Mandarin. One finalist, who had traveled 18 hours to Beijing, was so distraught at losing that she offered to let her veejay for a day. Anything to be a viewer.

By Kerry Capell in London, with Catherine Belton in Moscow, Tom Lowry in New York, Manjeet Kripalani in Bombay, Brian Bremner in Tokyo, Dexter Roberts in Beijing and bureau reports

Entertainment

HOW MTV CONQUERED ITALY

Monday through Friday, thousands of cheering teens crowd the streets near Milan's Duomo. It's not religion that has got these kids so worked up. Around the corner from Milan's famous cathedral are MTV Italia's studios, where bands from around the world appear on the show *Total Request Live*, or *TRL*. Some 12 million viewers watch MTV Italia every week, making it one of the most successful operations in MTV's roster.

Credit goes to Antonio Campo Dall'Orto, the 37-year-old managing director of MTV South, which includes MTV Italia and MTV España. Before joining MTV in 1997, the Milan native was No. 2 at Channel 5, which he helped turn into Italy's leading station. Now, Campo Dall'Orto's commitment to innovative programming for MTV—the station does four hours of live, original programming each day—is influencing the Italian music scene. "Our goal is to mix international culture with Italian tradition," says Campo Dall'Orto.

Italian teens say no other channel can match MTV's combination of local music and big-name international stars. "There are no proper music



A WINNING COMBINATION Dall'Orto, MTV Italia's managing director, mixes international culture with Italian tradition

programs on Italian TV except *The San Remo Song Festival*, which is boring," says Simone Longo, a 16-year-old Roman. Advertisers love it, too. MTV Italia is pulling in the highest ad revenues of all of MTV Networks International's channels, with a 352% increase since 1997.

Two of the channel's most popular programs, *brand:new:tour* and *MTV Supersonic*, are devoted to new acts. On *Supersonic*, a live-music show air-

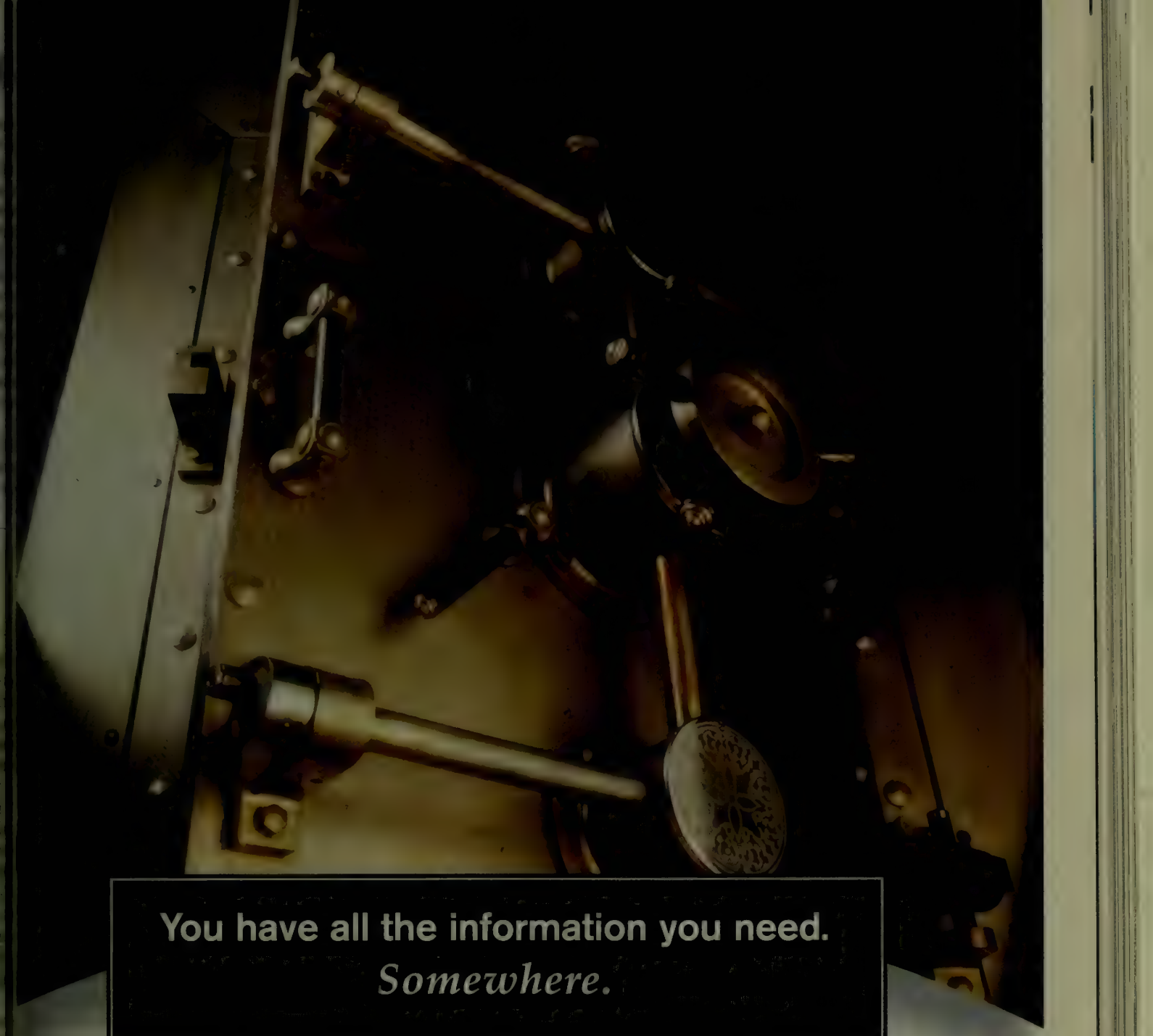
ing every Friday night, two well-known bands and an unsigned act perform a live gig. *brand:new:tour* is an annual program where six up-and-coming bands are selected to play at trendy clubs on a tour bankrolled by MTV. "Now young bands who were formerly underground in 1994 can fill whole stadiums," says Luca de Gennaro, the channel's head of talent.

MTV Italia also offers lifestyle programs. These include *MTV Kitchen*, where artists chat about music while cooking, and *Stylissimo*, a fashion program where guests include

the likes of Domenico Dolce and Stefano Gabbana. Another big hit: *Sexy Dolls*, where audiences are allowed live out their fantasies with pop-star lookalikes—within certain limits, of course.

Campo Dall'Orto is searching for new ways to extend the MTV brand. He has already dispatched backpacks, watches, and school supplies branded with the MTV logo to 2,500 Italian stores. "One of the reasons we love MTV is that you're always challenging the conventional wisdom," says. With shows like *Sexy Dolls*, that's easy.

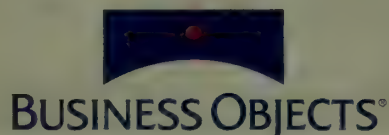
By Kerry Capell in London, with Stephanie Savariaud in Rome



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THE PENSION BOMB

Manna from pension plans inflated bottom lines in boom times. Now, profits will take a hit

Brace yourselves, investors. There's another big earnings booby trap lurking out there. Like other recent market stunners, companies set this one for themselves during the late 1990s when their traditional pension plan investments were earning outsize returns. Thanks to the wizardry of pension accounting, companies could apply those gains to their bottom lines, where they worked wonders on stock prices. Now, of course, most pension-plan returns stink. And the effect on corporate profits will be anything but wonderful. Stock prices are already signalling the message: Poor pension-plan returns will depress earnings for years.

General Electric Co., long criticized for using its plan to boost earnings, foreshadowed the trend late last year when it warned in a Securities & Ex-

change Commission filing that this year's pension earnings would drop between 5¢ and 7¢ a share from 2001. Soon after, General Motors Corp. said lower fund earnings were a factor in the quadrupling of pension expenses since 2000. A parade of industrial companies—including DuPont, Delphi Automotive Systems, Dow Chemical, Caterpillar, U.S. Steel, Exxon Mobil, and Ford Motor—followed suit.

The fall in pension earnings doesn't mean that companies will have trouble paying pensioners. That's because in the looking-glass world of pension accounting, the plan earnings that companies report are based on long-term projections that are not reconciled with actual earnings for years. Many companies say their plans did so well during the bull market that, despite the stock market rout, they won't have to contribute extra money for years.

But the days of flush plans are over for now. And that will hit corporations in several ways. First, some companies will have to start contributing again. More will have to stop tapping surpluses to cover other retiree expenses.



Most important, the post-Enron criticism about accounting is forcing companies to cut their assumptions for and beyond. "The auditors are putting much closer eye to pension numbers," says John Ehrhardt, a principal actuarial consultant at Milliman USA. Companies are calculating higher costs of providing for pensioners that is hurting their earnings. Such change accounts for about one-fourth of Delphi's higher pension expense in 2001, says John D. Blahnik, treasurer of General Motors spin-off.

Companies are also basing projections on smaller portfolios—those they still haven't fully marked down to their current market value. That's because they can average the value of portfolios over five years. 1999 stock prices are still inflating returns.

An even touchier issue is the assumption companies make on how their pension portfolios will earn. GE decided in November to trim its return assumption from 9.5% to 8.5%. Sounds small, but it could cost GE more than \$550 million, a hit of 2% to pretax income.

Dow Chemical Co. says it cut its assumed rate of return to 9.25% from 9.5% last year, helping knock \$100 million off its pretax results in 2002.

BIG BITE

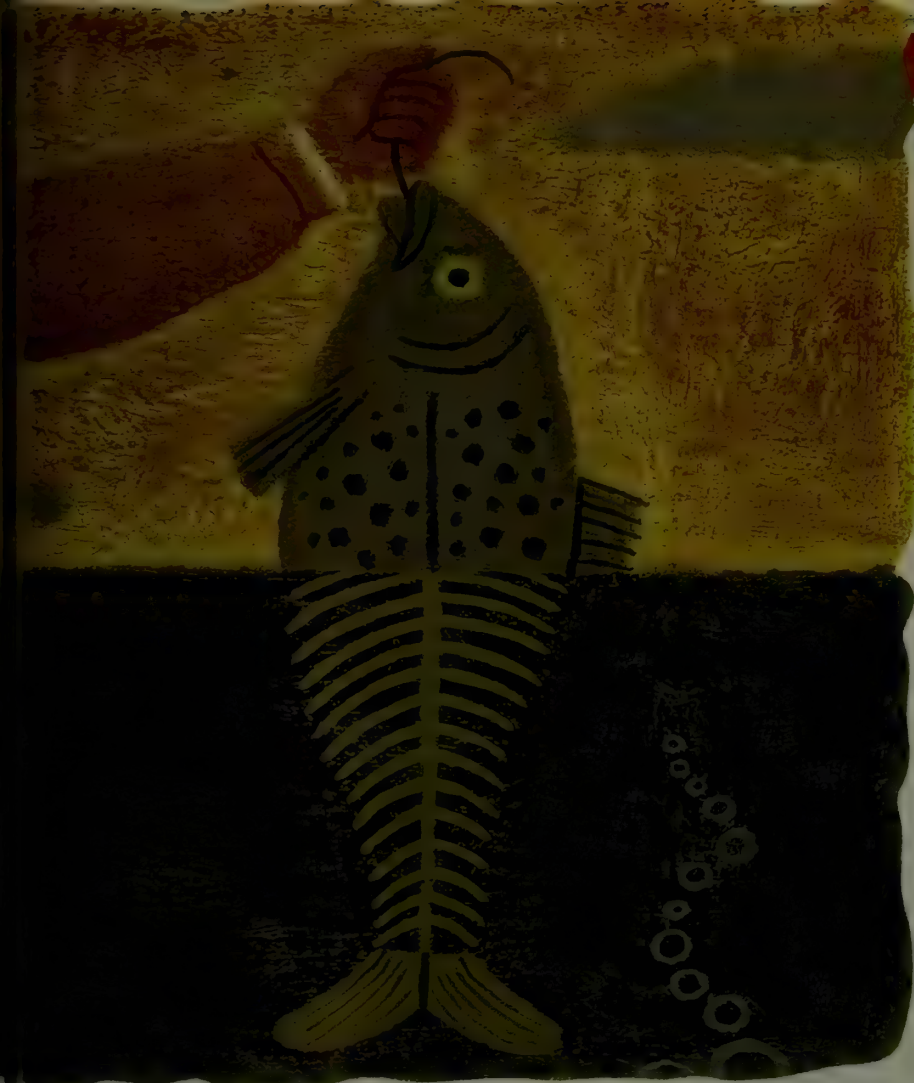
If companies cut overly optimistic pension-plan projections, profits will head south

	PENSION PLANS' ESTIMATED ANNUAL RATE OF RETURN*	ESTIMATED VALUE OF A ONE-PERCENTAGE POINT DROP IN RETURN (MILLIONS)	IMPACT ON PRETAX INCOME
DELPHI AUTO	10%	\$63	NA**
EATON	10	20	-7.2%
GENERAL MOTORS	10	767	-32.0
IBM	10	390	-3.6
CATERPILLAR	9.7	88	-7.5
UNITED TECH.	9.7	109	-3.9
DUPONT	9.5	200	-2.9
EXXON MOBIL	9.5	76	-0.3***
FORD MOTOR	9.5	345	-29.2***
RAYTHEON	9.5	123	-104.7
ALCOA	9	74	-4.5
ALLEGHENY TECH.	9	25	NA**
3M	9	63	-2.9

* Reported in 10-Ks for 2000

*** Through third quarter, 2001

**Company had pretax loss



million boost in 2000. Pool Corp. said in a 5 conference call it had cut its rate 10% for 2002 from last year. If the 50 st companies with on plans all sliced percentage point their projections, collective pretax income would fall \$5.2 billion, according to consultants Milliman. Why are companies going up to poor pension results only now? Well, the bear mar-

started 23 months ago. The reason that accounting rules let companies report big changes in pension gains for several years. But with losing value in 2001, many companies decided it was safer to come about the widening gap between pension projections and reality. The pension rules are a chief financial officer's dream—and an investor's nightmare. Each year, executives project a term rate of return for plan investments. The higher the rate, the lower the cost of providing the plan. But, if pension earnings exceed costs,

Accounting loopholes have kept the truth from emerging until now

the CFO can add the surplus to the bottom line. In 2000, about a third of the companies in the Standard & Poor's 500-stock index did so, boosting pretax income 12% on average, says Jane B. Adams, accounting analyst at Credit Suisse First Boston,

Companies can get away with off-base projections for years, and they can trickle out the adjustments over about 15 years. They argue the rules are good because

they keep pension-plan returns from causing wild swings in earnings. But critics, including investor Warren E. Buffett, say companies abuse them to gussy up weak results. Actuary Adrien R. LaBombarde at Milliman says, "You're delaying the inevitable and when it catches up to you, the change may be severe."

Pension accounting frustrates even the most inquisitive investors because most companies don't disclose clearly the assumptions they've used until after the yearend. Pension analysts say many companies are sticking to optimistic as-

sumptions despite the stock market weakness in the past two years—though in fairness, most underestimated pension returns in the 1990s. The companies in the S&P 500 projected 9.18% on average in 2000, a survey by consulting firm Watson Wyatt & Co. shows, and probably stuck with that in 2001. But the top plans eked out 1.3% gains in 2000 and lost about 8% in 2001.

Investors will start to get the bad news about pensions in the next few months as companies file their annual reports with the SEC. In a sign of things to come, Deere & Co., the tractor company, reported that its pension investments lost \$1.3 billion for its fiscal year ended Oct. 31, when it had figured they would appreciate by \$600 million.

Deere will likely be the first of many to deliver nasty surprises to shareholders. Auto parts maker Delphi, which employs 200,000 people, says pretax pension expenses will rise nearly 75%, to \$300 million from \$173 million, in 2002. Its plan assets contracted by 6% in 2001. Delphi posted a pretax loss of \$528 million for 2001 after restructuring charges. While about one-fourth of the added pension expense comes from early retirements, half reflects shrinking plan assets, says Blahnik. Caterpillar Inc. says diminished pension-plan assets are a factor in shaving \$121 million, or 35¢ a share, from earnings in 2002. DuPont says its plan will chop about \$155 million from earnings this year after adding \$65 million in 2001 and \$105 million in 2000. In 2001, stainless-steel maker Allegheny Technologies Inc. booked \$53.1 million in pension income and still reported a \$25 million loss. This year, plan income will fall by half, adding to the red ink.

Some companies say they won't change the assumptions about returns on their pension plans just because of a few bad years in the market. "We're saying where we think returns are headed over the next 30 years," says Delphi's Blahnik. The company is sticking with its 10% assumption, which proved conservative over the last 10 years when its plans earned 12.8% per year on average, he says.

Still, predicts Milliman's Ehrhardt, more companies will follow GE's lead to avoid criticism. If he's right, the impact will be worse in 2003. Ehrhardt expects companies will try to offset the hit to earnings by cutting employee benefits. Because of the arcana of pension accounting, the bear market will take a toll even after it's over.

By David Henry in New York and Michael Arndt in Chicago, with Diane Brady in New York and bureau reports

REGULATORS

ARE TWO HARVEYS BETTER THAN ONE AT THE SEC?

Soon, Goldschmid may join Pitt—and sparks could fly

When Harvey J. Goldschmid was general counsel of the Securities & Exchange Commission in 1999, his boss, then-Chairman Arthur Levitt Jr., often said he had the second-best job there. "Arthur always said, 'It's much better to be general counsel than just another commissioner,'" recalls Goldschmid.

Now, Gold-

Harvey Pitt fails to give sufficient deference to his colleague, it could get nasty," says another lobbyist. Neither Harvey would comment.

Goldschmid met with White House aides for vetting on Feb. 4. Although his nomination isn't guaranteed, President George W. Bush has agreed to defer to Daschle, who controls the Senate's confirmation process, on naming candidates

always fair: When Levitt proposed barring accounting firms from consulting their audit clients, Pitt worked for two Big Five firms that cooperated with Levitt on a compromise. But the chief has put some bullets in his wingtips, offering a weak plan for plining errant auditors that he negotiated with the Big Five and their group before he consulted Congressional investor advocates. "Harvey is suffering from a political tin ear," says one SEC observer. Adds a financial lobbyist, "Pitt is definitely damaged."

Will Goldschmid help? On many issues, he's almost the anti-Pitt. Goldschmid helped write the proposal for split auditing and consulting. And the two faced off over the landmark Private Securities Litigation Reform Act of 1995, which reduced account-



HARVEY vs. HARVEY

HARVEY J. GOLDSCHMID

- SEC nominee
- Democrat
- SEC general counsel 1998-99, Columbia law professor

HARVEY L. PITT

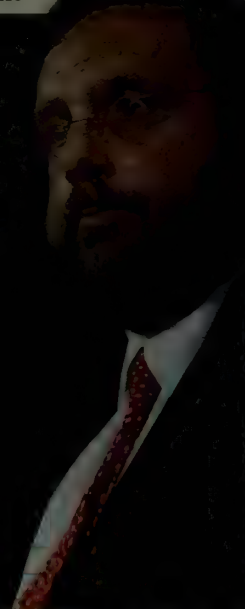
- SEC Chairman
- Republican
- SEC general counsel 1975-78, securities lawyer

WHERE THEY STAND

- Wrote Reg FD, which bars selective disclosure of corporate information
- Helped draft rules to separate auditing and consulting
- Opposed Private Securities Litigation Reform Act

- Opposed Reg FD; wants it to be reviewed
- Opposes accountants' dual role
- Advocated the law to discourage suits against company officials

Data: Securities & Exchange Commission, Columbia University, BusinessWeek



Goldschmid is heading back to the SEC as a commissioner—but not an ordinary one. Senate Majority Leader Tom Daschle (D-S.D.) has suggested the longtime Columbia University law professor for a Democratic seat on the SEC to counterbalance its Republican chairman, Harvey L. Pitt. Goldschmid is better placed than almost any other candidate to temper the absolute control over the SEC's staff and bully pulpit that the chairman usually enjoys. The result could be a shot in the arm for a struggling agency—or a battle royal over post-Enron securities regulation.

Securities lobbyists hope that two Harveys will be better than one. "These are two of the brightest securities-law minds in the nation," says one industry lawyer. But the potential for conflict is enormous: Pitt and Goldschmid are far apart on many issues (table). "If Harvey Goldschmid forgets who's chairman, or

to Democratic agency seats. By law, no more than three of the SEC's five commissioners can belong to the President's party. Daschle has suggested Roel Campos, general counsel at El Dorado Communications in Houston, for the agency's other Democratic seat.

The SEC could sure do with a boost. Pitt came in planning to overhaul 70-year-old securities regulations, modernize accounting and corporate disclosure, and dispel the hostility that built up between the SEC and its corporate constituencies during Levitt's record eight-year tenure. But the collapse of Enron Corp. has stopped Pitt dead in his tracks. Even Republicans in Congress now favor tighter regulations on accountants and corporate reporting.

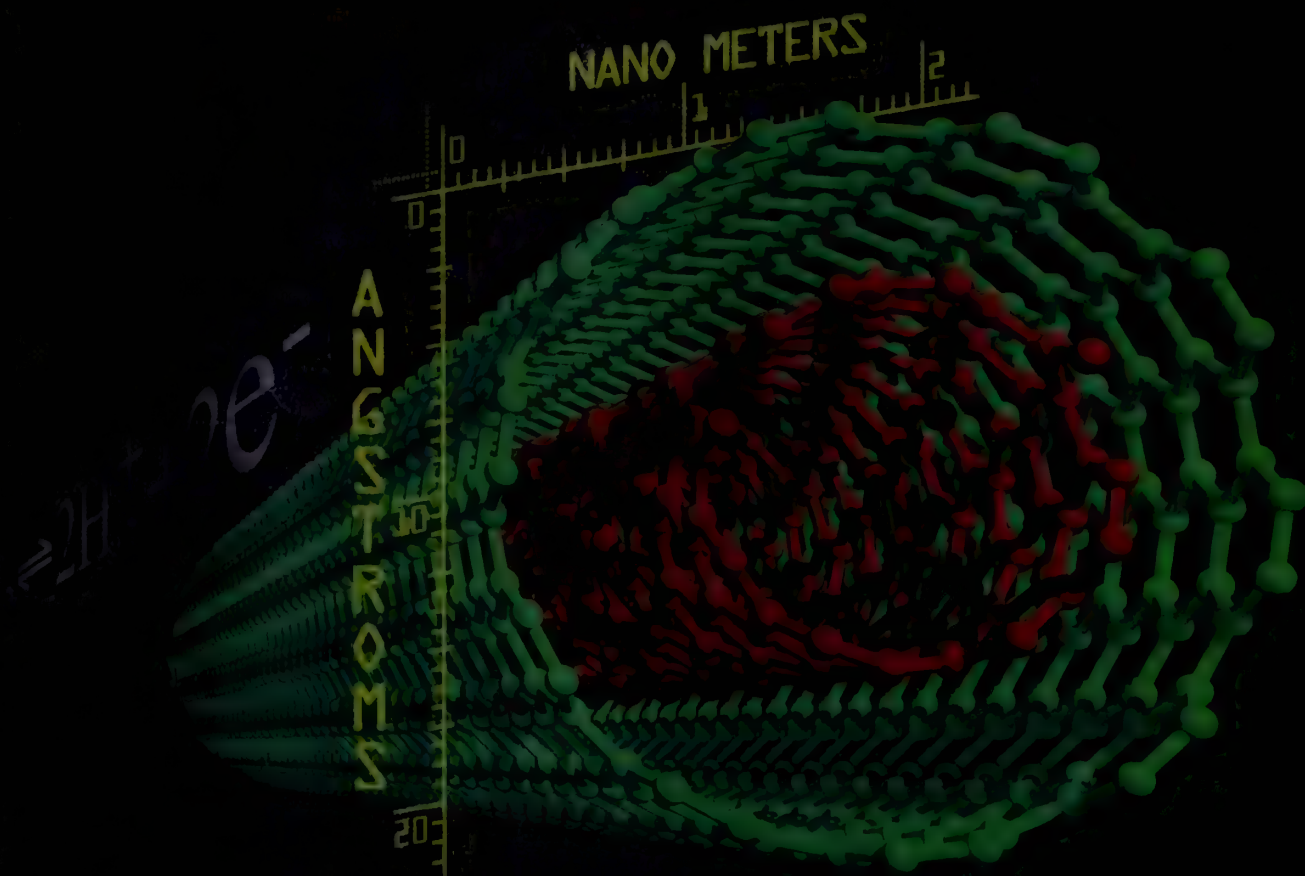
Enron has also cast a sharp spotlight on Pitt's background representing accounting firms, including Enron auditor Arthur Andersen. The criticisms aren't

ants' and executives' risk of being for financial fraud. That law, in the of some experts, set the stage for Enron's breakdown. Pitt testified in favor of limiting securities suits. Goldschmid supported President Clinton's law, which Congress overrode. As SEC general counsel, he successfully argued cases to ensure that the law wasn't used to limit fraud charges only to cap intentional abuse.

Associates say the two Harveys work to overcome their differences. They're both SEC loyalists who want to diminish the agency with open debates. And when they agree, joint proposals will gain tremendous credibility on Capitol Hill. But Pitt had any hopes that his broad derisory agenda was going to survive Enron, Goldschmid's arrival will be a reminder that times have changed.

By Mike McNamee in Washington

Innovative Solutions



Developing nanotechnology for quantum gains.

Through pioneering nanotechnology research, NEC is opening new frontiers. Today, NEC is a leading innovator in this important field. NEC has demonstrated precise 3D nanometric scale production that points the way to ultra-miniature devices like biosensors and highly efficient optical communications components. Low cost, long lived and environmentally friendly mobile power sources based on carbon nanotube fuel cells may also result from our advances. Empowered by innovation, our expertise in networking, systems integration and custom semiconductors helps NEC develop optimum solutions in broadband, mobile Internet and more. For information visit www.necus.com or call 1.800.338.9549.

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NEC

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CORPORATE FINANCE

IN BIOTECH, PRIVATE CASH IS KING

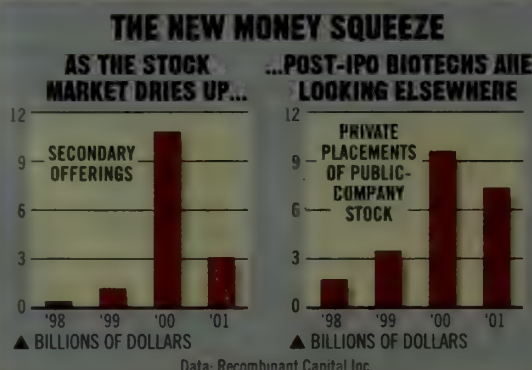
Big investors are finding they can strike sweeter deals

After Rigel Pharmaceuticals Inc., a young biotech company in South San Francisco, Calif., went public in 2000, its financing options seemed wide open. But by the time it needed cash for such projects as trials of a new asthma drug, the public market had turned cold, says Chief Financial Officer James H. Welch. Rigel did raise \$31.5 million in late January, but only by placing 7 million new shares directly with about a dozen institutional investors at \$4.50 per share—a big comedown from the \$7 initial-public-offering price. “We needed to make sure we had adequate funds to get our products into [human trials],” says Welch.

Many listed biotechs are in the same boat. In 2000, they raised \$18.5 billion in the public markets, \$10.8 billion of that from secondary offerings, according to research firm Recombinant Capital. But in 2001, they got only \$3.5 billion from the public markets. And the trend is not likely to improve soon. Recently, several companies, including Abgenix, Cubist Pharmaceuticals, and Inspire Pharmaceuticals, have had high-profile product-development setbacks. And the debacle at ImClone Systems Inc. (page 88) has made investors nervous about biotech. ImClone’s eagerly anticipated

cancer drug, Erbitux, faces an uncertain future after the Food & Drug Administration questioned the adequacy of its clinical trial. “This is a hesitant market—and one that is suspicious,” says Robert J. Towarnicki, CEO of Cell Pathways Inc. in Horsham, Pa.

That public suspicion is giving private investors an opportunity. According to industry newsletter *Venture Capital & Health Care*, 33 vc funds that focus exclusively on health care raised a record \$5.3 billion in 2001. Some of those funds are even taking stakes in out-of-favor public companies. Plus, many private equity funds are putting their money to work in both public and private biotech companies.



ALMOST THERE

Even those with drugs in late-stage trials, such as La Jolla Pharmaceuticals, must sell shares at a discount

But private investors are fun only the most promising prospect. Jolla Pharmaceuticals Co., for example, raised \$51 million in January thanks in part to the buzz surrounding its drug for the autoimmune disease lupus that is in the final stage of human testing. Says Chairman and Executive Steven B. Engle: “We were surprised at just how strong the interest was.” Even so, the company to use a PIPE—a private investment in public equities. In a PIPE, investors buy new unregistered shares at a discount. These become tradable public shares after a few months. Existing shareholders dislike PIPEs because they dilute the value of their shares. Biotech companies say they can afford to wait until the public market reopens. La Jolla was lucky: Its offering was oversubscribed and priced at a moderate 8% discount to the market quote for regular shares of around \$10.

For companies without late-stage products—notably those with technologies for developing drugs—the market is likely to be cooler. Dennis J. Cell, senior managing director at Perseus-Soros BioPharmaceutical, believes many may end up selling out or merging with other biotech companies. In December, Exelixis Inc., a gene company that is trying to develop cancer and other drugs, bought GenCorp., a struggling company that develops systems to crunch molecular data generated by the mapping of the human genome. Exelixis paid just \$10 million for Genomica, which had raised that amount of cash on its balance sheet. “We essentially got the company for nothing,” says Glen Y. Sato, financial officer of Exelixis.

The other option is for biotech to partner with Big Pharma. Bristol-Myers Squibb Co. announced a \$1.5 billion deal for co-manufacturing rights to ImClone’s cancer drug, biotech executives are more cautious and are exacting better terms. In any case, the tightness of the market cash right now is making the biotech business riskier than usual.

By Amy Barrett
Philadelphia and Ellen
ing in New York



Love is something that everyone should experience. Especially on Valentine's Day. So here's the perfect place to find it: chrysler.com. While you're there you can send free e-valentines to loved ones. Or set up a test-drive and discover that any Chrysler you choose has a certain something that is almost indefinable. Kind of like love.

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Drive = Love

BANKING

FLEET'S FLEETING DREAMS

Bad loans and Argentine debt are hurting the once-rich bank

When New England's two largest banks announced in March, 1999, that they would merge, the deal was billed as a winner. FleetBoston Financial, a combination of Fleet Financial Group and BankBoston, had \$180 billion in assets—nine times more than its next-biggest regional rival, Citizens Bank. Executives trumpeted the merged bank as a mighty profit machine and a springboard to global growth. "Together we will build a new company with a new culture for a new century," declared Charles K. Gifford, then Bank of Boston chairman.

In January, Gifford became Fleet's CEO. But instead of taking over a sleek dynamo, he's stuck with a clunker that needs major repairs. Fleet is deep in the red, with more bad news to come. In the fourth quarter of 2001, the bank lost \$507 million, due in part to the economic crisis in Argentina, where it is one of the largest foreign banks. Even more worrisome, it piled up bad loans faster than many of its peers. Nearly all of the bank's major business lines saw profit declines last year, and its stock is 24% below its premerger price.

Investors are fed up. "We're at the maximum point of pessimism on Fleet," says James Ellman, manager of Merrill Lynch Global Financial Services Fund, which owns some 1 million shares.

As a result, Fleet's future hangs in the balance. Despite its size, the bank has not been able to produce big profits. Its return on assets fell from 2.2% to 0.44% in 2001, vs. an industry average of 1.02%. Executives have acknowledged that Fleet may quit Argentina, where it has done business for over 80 years. Outsiders say Fleet may consider selling its investment bank, Robertson Stephens Inc., because it isn't

happy with the volatile earnings the business brings in.

Some market players are betting that Fleet could wind up being swallowed by another bank hungry to consolidate. It has long been rumored to be a prime acquisition candidate for Citigroup, largely because Fleet would give Citi

instant entrée into New England's net-worth retail-banking market. Ellman believes a deal could open later this year, after Citi generates extra cash from spinning off its insurance unit. In fact, he's buying stock on the dips because of it. He thinks investors will look favorably on the deal, enabling Citi to pay a premium of 5% to 10% to win shareholder approval. Neither Citi nor Fleet would comment.

Clearly, Fleet is scrambling for answers. CFO Eugene McQuade recently told shareholders that "we obviously made investments in the last few years we wished we hadn't." He added that volatility in earnings "is causing us to rethink what the right business is." Gifford has pledged to return

to the bank's roots. On Jan. 30, he told shareholders at an investor conference that he will emphasize businesses such as consumer and corporate banking.

Pulling off a quick turnaround will be tough. Fleet has focused on improving its poor customer service in retail banking. And its 2002 strategy includes a big push in the New York City area. Competition there is stiff: Washington Mutual Inc. and Commerce Bancorp. are both with reputations for excellent customer service, are moving quickly. Fleet has lost customers in Commerce in some parts of New Jersey. Deposits at Commerce branches increased more than 10% when Fleet took over Summit Bank Corp., as Commerce wooed away happy customers. "In New Jersey, Fleet has become a wounded dinosaur," says Commerce Bank CEO Vernon W. Hill II.

While many big banks are being pinched by bad loans, Fleet is feeling the pain more than most. In the fourth quarter, the bank lost \$175 million in Enron debt and \$100 million in Kmart debt to reorganizing status. Salomon Smith Barney estimates that bad loan losses increased industrywide by 17% in the quarter—but by 25% at Fleet.

Undaunted, Gifford is pressing for a sharp profit rebound this year, about \$3.2 billion. Anything less than that will only turn up the heat on investors looking for a breakeven sale. Fleet is certainly a new but old problems may cost it independence in the new century.

By Geoffrey Smith in New York and Heather Timmons in New York

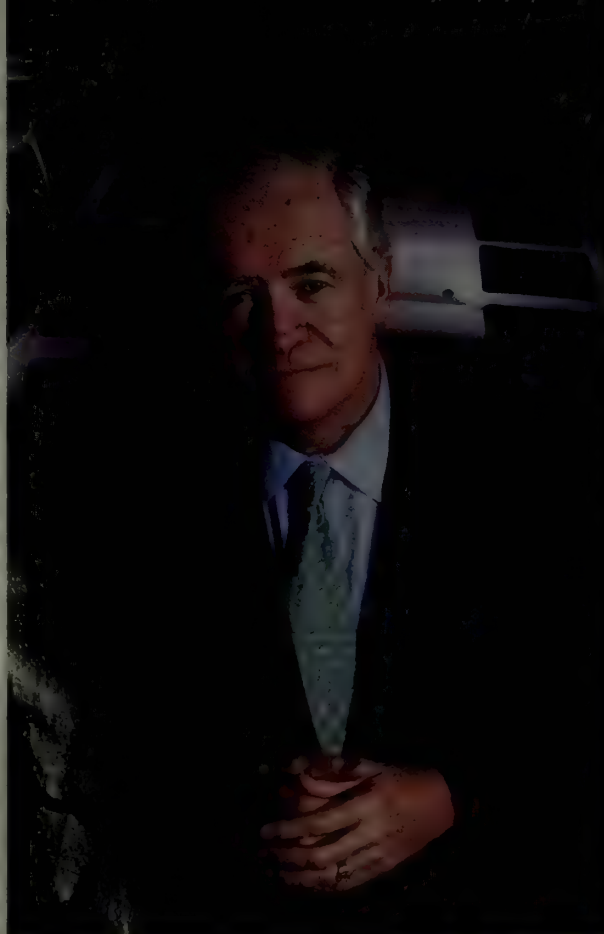
NEEDS IMPROVEMENT

Fleet scores low compared with other U.S. banks

	FLEET	INDUSTRY AVERAGE
RETURN ON ASSETS	0.44%	1.02%
RETURN ON EQUITY	5.49%	14.4%
RISE IN BAD LOANS	25%	17%
NET INCOME PER EMPLOYEE*	\$15,500	\$45,600

*3rd Quarter

Data: Standard & Poor's, Market Guide Inc., Salomon Smith Barney, company reports



CEO

GIFFORD:

Turning things around this year will be tough

BY ELLEN LICKING

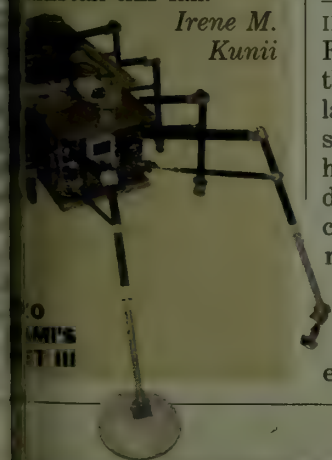
ROBOTS THAT TAKE LAND MINES

WAR-TORN COUNTRIES such as Cambodia and Afghanistan, land mines kill or maim some 2,000 people a month. Horror stories of these casualties—many of them children—have spawned a wave of innovative detection technologies, including an autonomous spiderlike robot called Comet III.

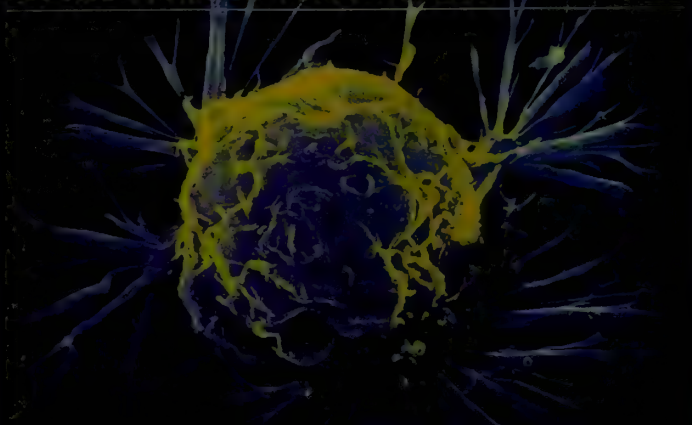
The gas-powered, six-legged machine, which cost \$375,000 to build, is the brainchild of Kenzo Imai, a mechanical engineering professor at Osaka's Chiba University. As it crawls along, the robot sweeps the ground with one of its sensorized arms. When it locates a mine, it marks the spot with a paint-filled air gun. At the same time, computers in the robot's brain parse data from the mine detectors and from built-in global positioning system sensors. As the information is collected, it is continuously relayed back to a control center.

In a second, simpler robot called Comet III on its way. Once a mine site is marked, this robot steps in and remotely detonates the bomb. No one has high hopes for these creations, which will make their debut in Afghanistan this fall.

Irene M. Kunii



ON THE TRAIL OF TUMOR CELLS



ONCOLOGISTS HAVE LONG KNOWN THAT SOLID TUMORS slough off cells with surprising speed. The more aggressive the tumor, the more cells it sheds. And each cell has the potential to spawn a new tumor far away from the original site.

Scientists at the closely held Immunicon Corp., based in Huntingdon Valley, Pa., think they can take advantage of this shedding process to provide an early warning on tumors. They have developed an exquisitely sensitive test that detects small numbers of tumor cells circulating in the bloodstream. First, blood cells are mixed with a suspension of tiny magnetic particles. The particles are armed with specialized tags that glom on to any cancer cells in the sample. When the sample is placed in a magnetic field, the cells bound to the particles are separated from the rest and can then be analyzed. In trials, the test proved sensitive enough to detect as few as 10 cells in a 7 milliliter vial of blood.

The company is conducting clinical trials to see if the technology can be used to monitor how well breast-cancer patients respond to different therapies. If the cancer is under control, the number of tumor cells picked up by Immunicon's test is expected to decrease.

HOW TO NEUTRALIZE LUGGAGE BOMBS

IN DECEMBER, 1988, PAN AM Flight 103 was knocked from the sky over Lockerbie, Scotland, by a bomb hidden in a suitcase in the plane's cargo hold. That spurred efforts to develop a blast-proof cargo container. Now, Telair International has unveiled the first commercial container to pass the Federal Aviation Administration's internal-explosion tests.

The Rancho Dominguez (Calif.) company's container is basically an overgrown soft-sided suitcase. The sides are a composite based on DuPont's Kevlar, the plastic fiber from which bulletproof vests are woven. When the FAA set off test blasts, the container "just puffs out like a large balloon," says Telair General Manager Dennis K. Staver. Initially, the container will cost "substantially more" than a standard aluminum unit, he concedes, but the premium will diminish as production grows.

Otis Port

SAFETY FOR PATIENTS, SAVINGS FOR HOSPITALS?

A PAPERLESS OFFICE MIGHT save money, but a paperless hospital could also save lives. Indiana is set to open the nation's first digital heart hospital at the end of this year, with help from new technology by GE Medical Systems. The \$60 million, 88-bed facility will give doctors at the patient's bedside instant online access to everything from medical records to menu preferences. That could save hours that are now spent looking up prescription data, test results, and other information.

Built into the so-called GE Centricity system is sophisticated software that screens a patient's medical history and issues warnings about potential allergies or drug interactions. Medical errors are estimated to kill up to 98,000 people a year, according to a recent Institute of Medicine report. But a Dartmouth Medical School study has found that computerized doctor order-entry systems such as GE's could cut the number of serious medication errors almost in half.

Community Health Network, the prime investor in the project, also hopes the Indiana Heart Hospital will deliver big cost savings. David Veillette, CEO of the new facility, expects the technology to help the hospital handle three times as many patients with fewer staff than normally required. "With the stroke of a key, I will have the patient's history and even access to electrocardiograms," says Veillette. What's more, in the event of a computer crash or blackout, doctors will be able to retrieve data from an off-site backup computer system that has its own power supply and is updated each time new information is entered.

Diane Brady



the disease researcher

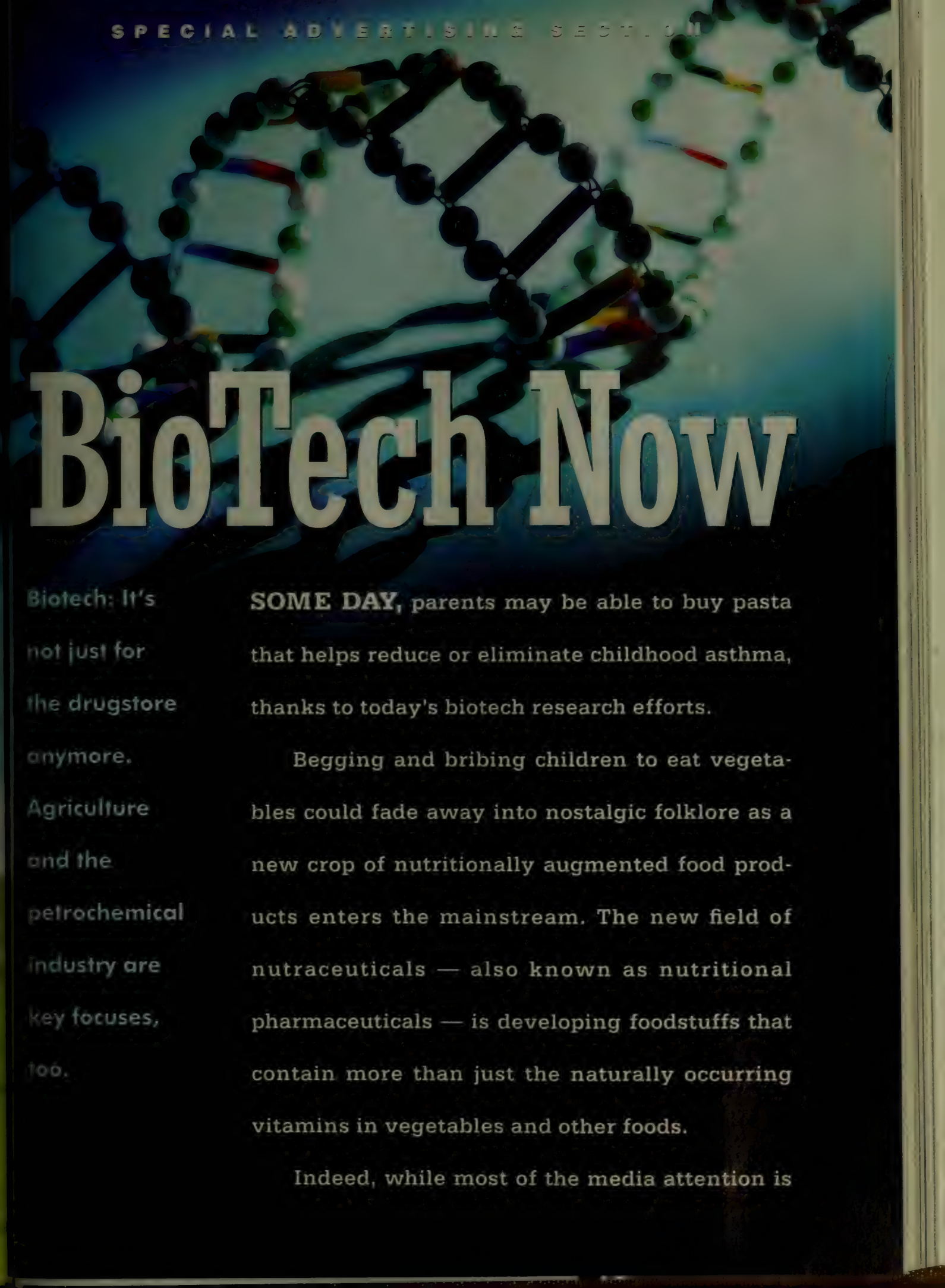
dreams of moving faster

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dreams made real



BioTech Now

Biotech: It's not just for the drugstore anymore. Agriculture and the petrochemical industry are key focuses, too.

SOME DAY, parents may be able to buy pasta that helps reduce or eliminate childhood asthma, thanks to today's biotech research efforts.

Begging and bribing children to eat vegetables could fade away into nostalgic folklore as a new crop of nutritionally augmented food products enters the mainstream. The new field of nutraceuticals — also known as nutritional pharmaceuticals — is developing foodstuffs that contain more than just the naturally occurring vitamins in vegetables and other foods.

Indeed, while most of the media attention is

focused on new miracle drugs coming from the definition of the human genome and other recent advances in biotechnology, a host of nonpharmaceutical advances is the result of the confluence of biology, chemistry and information technology. New substitutes for the raw material of plastics, enzymes that help dissolve pollution and other industrial products, are coming out of the labs and into the mainstream of business life, courtesy of biotechnology.

How distant are these scenarios? The technology and science for much of this exists today. It's just a matter of bringing the cost down, figuring out who pays for it, building in privacy safeguards and educating the various professional communities about the vast potential biotechnology will bring to everyday practices in the next decade.

With hundreds of applications for agriculture and other industries pending as well as more than 300 med-

says Matt Kremer, senior director of corporate communication at Neose Technologies, a leading developer of proprietary technologies for the synthesis and manufacture of complex carbohydrates. "We can't estimate how dramatically it will change our lives."

New Approaches

One good sign is the variety of new approaches that not only treats patients better, but provides good financial potential for healthcare companies.

Consider cancer research. Historically, those efforts have been focused on finding a cure, a treatment that would eliminate all cancer cells from the patient and potentially prevent the disease from returning. Today's cancer efforts, though, are focused more on allowing the patient to live a normal lifespan with the cancer present but rendered harmless. That would mean an almost endless need for the prescribed drugs and other treatments.

"Clinical research results up until now tend to indicate that the solution to treating some forms of cancer resides in controlling the disease instead of a complete cure. In other words, antiangiogenic products could make it possible to control cancer just as we have been able to do with diabetes," says Claude Hariton, vice president for clinical and regulatory affairs at Aeterna Laboratories. "A patient could therefore live with a tumor, which could be maintained in a latent stage."

And there is other good news for investors. Unlike the dot-com businesses, biotech companies are led by mature executives with real business plans and enough capital to see them through the next five to 10 years. As a result, outside investment — fueled by the hundreds of products in the pipeline, the significant money biotech companies have earmarked for research and development, and the unique advantages biotech products have over pharmaceutical drugs — is expected to continue throughout the decade.

Among its advantages, biotech products are not pressured by the patent expiration and generic equivalents hitting the pharmaceutical industry, says Scott W. Morrison, a partner in the consulting firm Ernst & Young, who coauthored the firm's October 2001 depth analysis of this industry.

Over the next several years, for instance, pharmaceutical companies will face patent expirations on drugs that produce about \$100 billion in annual sales. Most biotech drugs, however, are patent protected until the beginning of the next decade, while development of generic biologics — the biotech equivalent of the generic and so-much-cheaper prescription drugs — hasn't even started.

Another plus is that biotech drugs tend to have applications for multiple diseases. The rheumatoid arthritis drug Enbrel (marketed and manufactured through a joint agreement between Wyeth-Ayer Laboratories and Immunex), for instance, blocks

TIPS

Invest for the Ages

R&D dollars are showing respect for elders. Nearly 30 percent of the more than 300 biotech products in Phase III clinical trials are for cancer; 11 percent on the nervous system, including Alzheimer's and Parkinson's disease.

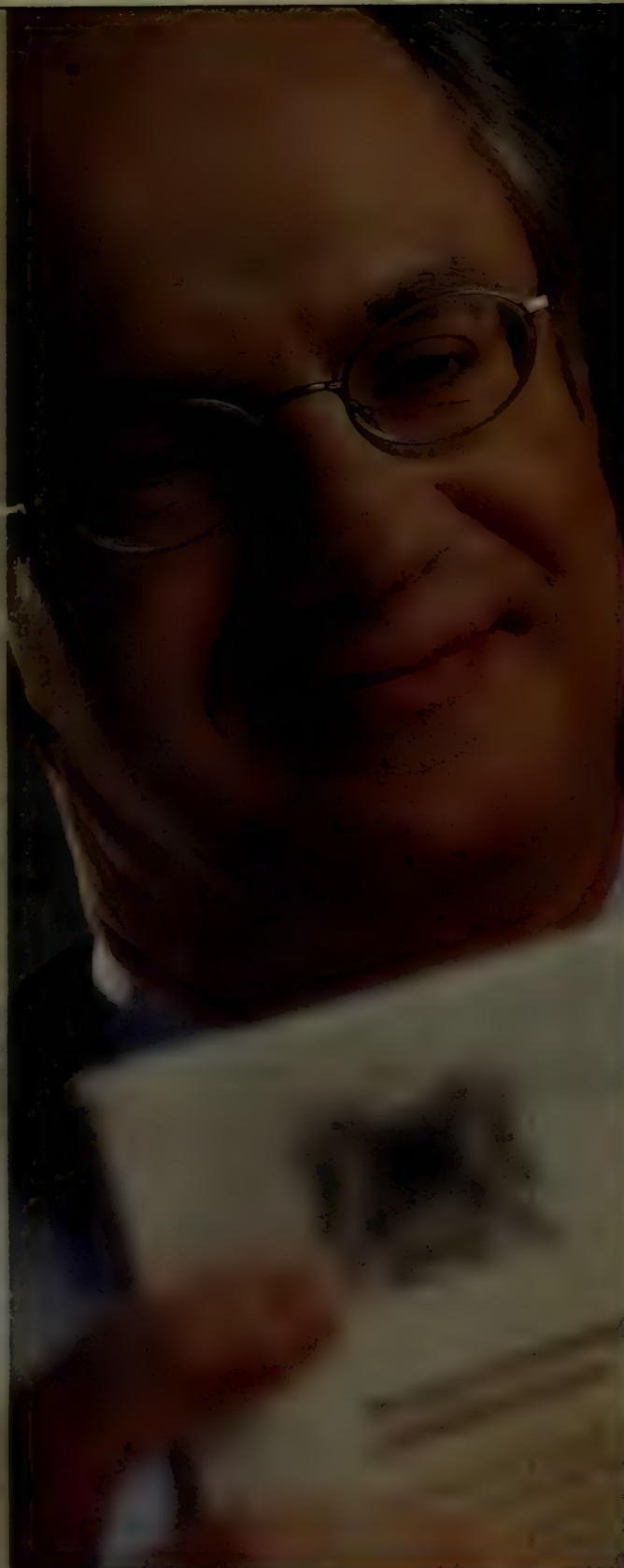
ical products in the final stages of the drug development pipeline — Phase III clinical trials, or the final step before companies apply for approval from the Food and Drug Administration — the \$25-billion biotechnology industry is poised to affect every aspect of people's lives within the next decade, from the foods consumed to the vaccines received to the diagnostic tests taken.

The reason is simple: People want to live longer without getting sick. And biotechnology, which pinpoints medical treatments to the individual actions and messages hidden within genes, cells and proteins, offers that hope.

"There is a great demand for new therapies and cures for currently unmet medical needs," says Carl B. Feldbaum, president of the trade group Biotechnology Industry Organization. "The markets for new products in these areas are wide and deep and getting wider and deeper as the Baby Boomers age."

Consider: While development of small molecule drugs by traditional pharmaceutical companies is growing at a rate of seven percent a year, biotechnology-based small-protein drugs are growing at a rate of 15 to 20 percent a year.

"Biotechnology is another industrial revolution,"



The Discovery Moment

The next gene.
The next disease pathway.
The next drug.

All the answers are
there in the body.
We just need new
ways to find them.

New ways to get at what's
relevant about results.

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there are suddenly connections.
And what used to look only like work,
now points to solutions.

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protein called tumor necrosis factor (TNF), which is involved in numerous inflammatory diseases. Thus, TNF is expected to have uses in conditions such as juvenile arthritis and psoriatic arthritis.

"The total potential for a product like this is in the multibillion dollar range," says L. Patrick Gage, Ph.D., senior vice president for science and technology at American Home Products and president of Wyeth-Ayerst Research.

Rhetoric and Reality

The biotech industry received a burst of atomic power in 2000 with the identification of the 30,000 to 40,000 genes that make up the human genome. While this opens up thousands of new avenues of discovery, it's been a bit like uncovering a new world.

"Now you're here, what do you do with it?" asks Lauren Linton, Ph.D., vice president of applications, marketing and R&D at Applied Biosystems, who worked on the Human Genome project while at the Massachusetts Institute of Technology's Whitehead Institute.

With about 40,000 genes to work with, "there is an unbelievable target overload," says Ernst & Young's Morrison. "The bottleneck is in deciding which ones we can or can't develop drugs for. Functional genomics is just the starting line; the finish line is being able to

TIPS

Good Biotech Patent News

Pharmaceuticals soon face patent expirations on many key drugs. Most biotech drugs, however, are patent protected until the beginning of the next decade, while development of generic biologics hasn't even started.

understand the function of genes and the interaction of proteins in the disease process."

This ongoing effort will change the way medicine is practiced, experts predict. Using biochips — glass silicon wafers that function as a kind of search function to quickly accelerate the sequencing of DNA — for example, doctors will be able to analyze thousands of genes and proteins at once, notes Morrison in his report. They then will be able to use that information to develop personalized medicine, including treatment and disease prevention strategies based on each patient's specific genetic profile. Thus, medicine will shift from an acute clinical practice to one of prevention.

Even as the biotech industry grapples with the human genome, researchers already are delving into the next step: proteomics, the understanding of hundreds of thousands of proteins — most of which play a role in health and disease — that genes encode. If genes tell people what they may be, then proteomics tell people what they are.

Genes code for proteins, much like a blueprint for a house. The individual elements that go into building a house — the wood, the glass, the wiring — are the proteins. Figure out how to make the house warmer, more secure and fireproof, and you have an overall "healthier" house. Figure out the role individual proteins play in health — and disease — and target drugs to either block or promote their actions, and you have an overall healthier person.

Dozens of small companies are springing up around single proteins, notes the Biotechnology Industry Organization's Felbaum. With thousands of proteins — and perhaps more — in existence, "the economic opportunity to access these proteins is pretty remarkable," he says.

Breaking the Logjam

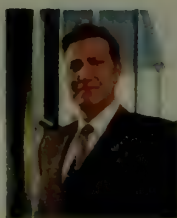
The focus on functional genomics and proteomics has spurred demand for an immediate payoff in new products, notes Ernst & Young's Morrison. "But the fact is, what you put in the pipeline takes an enormous amount of time to come to market."

An average of 10 to 15 years, in fact, is required. This timetable poses one of the greatest challenges

CORPORATE SPOTLIGHT

Æterna Laboratories Inc.

Developing New Ways of Treating Cancer



Chairman & CEO, President:

Dr. Éric Dupont, PhD

Year Founded: 1991

Number of Employees: 150

URL: www.aeterna.com

Æterna Laboratories Inc. (NASDAQ:AELA, TSE:AEL) is a biopharmaceutical company focused on developing new therapies, mainly in cancer. Its lead compound, Neovastat, is in late stage clinical trials in lung and kidney cancer, as well as in multiple myeloma, a form of blood cancer, involving over 1,000 patients in 140 clinical institutions across America and Europe. Neovastat could be the first angiogenesis inhibitor to reach the market as early as 2003.



ne medical biotech industry. "For the industry to be as productive as it needs to be to justify today's market valuations, there has to be a very significant increase in productivity," says Stephen Hill, president of ArQule, which collaborates with pharmaceutical and biotechnology companies in the area of drug discovery.

Over the next three to five years, he notes, the industry needs to halve both the six years it currently requires between target identification and investigational new drug (IND) filings and the \$50 million it costs to bring a drug to clinical trials. It also needs to bring 30 percent of those compounds successfully through clinical trials to approval, rather than the 10 percent that make it today.

Analysts expect such productivity gains will come as increasingly powerful technology is designed to enhance what used to be a painstakingly slow discovery process. Today, for instance, instead of 20 experiments a week, companies run 20,000 a day.

Expect Explosive Growth

With the largest demographic in the country's history soon eligible for Social Security, it's no wonder the majority of products in the medical biotech pipeline target diseases of aging. Nearly 30 percent of the biotech products in Phase III clinical trials are for cancer. Another 11 percent target the nervous system, including Alzheimer's and Parkinson's disease.

By 2007, as many as 240 new medicines should reach the consumer market, including expected blockbuster drugs in the areas of cancer and heart disease.

But scientists know that biotech's magic extends far beyond the doctor's office. The lab technician's test-tube racks will be improving the grocery store, the hardware store and, ultimately, the boardroom.

Overall, says Ernst & Young's Morrison, "we think we're at the very beginning of the technology curve. We see really explosive growth in this industry until the latter part of this decade." ■

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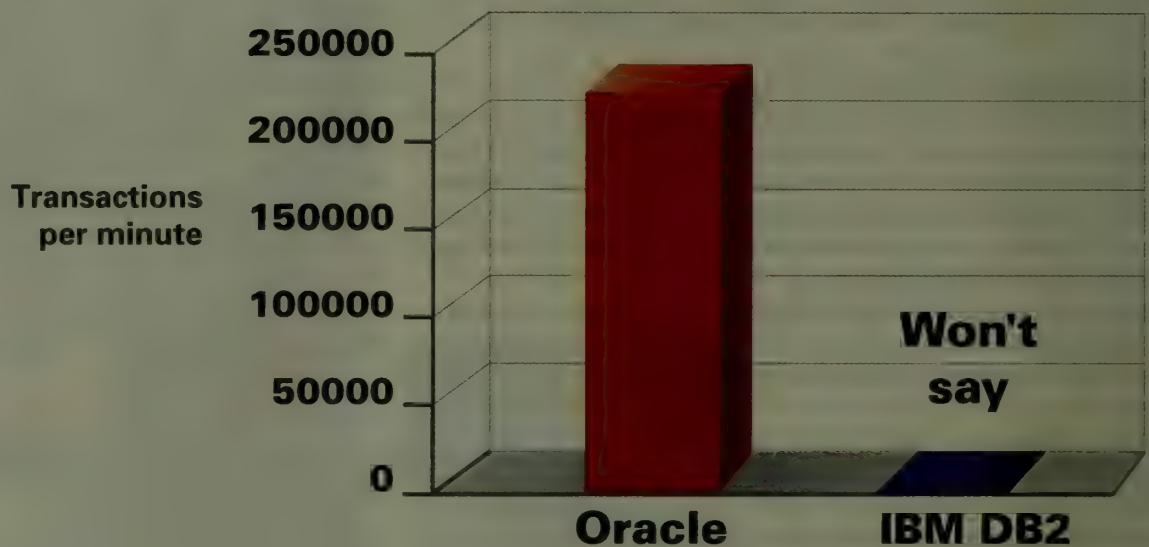
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What's the fastest database on IBM's fastest computer?



Source: IBM press release

When IBM wanted to show off
their fastest new computer,
IBM chose Oracle.
Interesting.

ORACLE

As of June 22, 2001 Oracle, \$34.18/tpmC on
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MAKING LIFE RICHER

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■ Finding
Higher Yields

■ Hers: A New
Leadership
Index

■ Barker:
Fund Director
Disclosure



Is Your Broker Leaving You Out in the Cold?

The new focus on high-end clients means less service for many

BY SUSAN
SCHERREIK

The high and low ends of the market are likely to get better service. It's those with six figures to invest who may get fewer calls and invites to be wined and dined

Have you noticed that the stockbroker you used for years hasn't called you lately? It could just be the bear-market blahs, but perhaps not. If your account has been deemed too small—which could be the result of following your broker's advice—the lack of attention may be deliberate.

In fact, some of the biggest firms are taking a new approach to smaller accounts. Over the past year, more than 1 million investors with five-figure accounts have been switched to call centers. So teams of brokers now provide the advice clients previously got from one dedicated broker.

Pinched by the market and the recession, brokerages are looking to solutions such as call centers to cut costs and squeeze more profit out of existing customers. "During the bull market, brokerage firms measured success by how many accounts they had," says Bear Stearns financial-services industry analyst Amy Butte. "Now, they focus on the profitability of each account."

This new focus on profitability is likely to mean better service for both the high and low end of the market, while the middle segment is in flux. For those with the smallest accounts, which at Merrill means one with assets of \$100,000 or less and at Prudential, \$25,000 or less, the teams at call centers may offer better service since most brokers never gave these clients much attention anyway. For those with \$1 million-plus accounts, competition for this segment of the market is driving fees down. In addition, brokers are beefing up estate planning

and other high-end services. It's those with investable assets low to high six who may notice while they still broker, that person not call as often or vesting ideas or out invitations to investment seminars, golf outings. While Prudential and Prudential leading the call trend, in coming more firms are likely

launch them as well. You're also likely higher asset cutoffs for who gets a call and who gets a broker.

How do you get the attention you think deserve? If you keep accounts with several brokerage firms, the simplest solution is to date them to boost your clout at one firm. Harvey, president of Dalbar, a financial-research firm in Boston, says the typical maintains accounts at three firms. That once gave investors access to a wider array of investment research. "But with the



d CNBC, everyone gets the same investment news, so there's no longer a need to have more than one firm," Harvey says. "I'll also wind up paying proportionally less on one big account. Competition from Internet brokers and online trading has slashed brokerage commissions. So many big firms are pushing fee-only accounts in which investors pay a percentage of assets annually, whether traded or not. Fees are set on a sliding scale on account size. Steve Liguori, head of marketing at Morgan Stanley, says less than 10% of the firm's clients have fee-based accounts, but they are the fastest-growing segment of its retail business. In Morgan Stanley's program, investors pay annual fees ranging from 0.3% to 2.25% of assets. In Merrill's Invested Advantage program, investors pay 1% of assets for the first \$1 million of a stock portfolio, 1% of the next \$4 million, and 0.75% of assets over \$5 million. Another option is to move your money to a "boutique" brokerage where smaller accounts benefit from lots of personalized service. Wall Street firms call these firms regionals because they are not based in New York. Nevertheless, the industry can be broad. A.G. Edwards in St. Louis employs 7,351 brokers in 701 branches

and a ray of sophisticated products.

For larger accounts, financial planners generally work for a fee rather than a commission. If you have \$1 million, a seasoned planner will charge about 1% of assets annually for investment management. If you have \$100,000 to \$500,000, expect to pay up to 2% of assets. For investors with smaller accounts, it makes more sense to hire a planner on an hourly basis. About half of all planners let clients pay this way, typically charging \$100 to \$200 an hour. One group that offers hourly rates is Garrett Planning Network, which has 90 planners around the country. The firm's Web site, www.garrettplanningnetwork.com, provides a list of planners by location.

Another alternative: former "discount brokers" such as Charles Schwab or Fidelity Brokerage Services. Sure, these firms largely deal with clients through call centers and on the Internet, but they also have scores of offices where investors can do business face to face. At Schwab, for instance, investors can usually see the same financial consultant at their local branch office if they want to, says Schwab spokesman Greg Gable.

For many customized services, however, it's pay as you go. Schwab charges \$400 for a complete analysis of your portfolio holdings and several hours of personal advice through its Portfolio Consultation program. A more detailed financial plan from a Schwab consultant costs \$1,000. Schwab can also refer you to its network of 450 independent financial advisers if you have at least \$100,000 in assets. At Fidelity, if you have \$50,000 or more, the firm will manage

a portfolio of mutual funds for an annual fee equal to 1% of your account size.

Bear Stearns's Butte expects Schwab and Fidelity to beef up services and products over the next few years by striking deals with Wall Street firms, as Fidelity has done with Lehman Brothers. Fidelity customers can tap Lehman's stock research as well as buy shares of initial public offerings the investment bank underwrites.

In the meantime, don't dismiss the call-center approach out of hand. You may get more attention than you were getting before. "You're a big

Getting A Broker's Attention

With brokerage firms shifting their focus to wealthier, more lucrative clients, investors with small accounts may get short shrift.

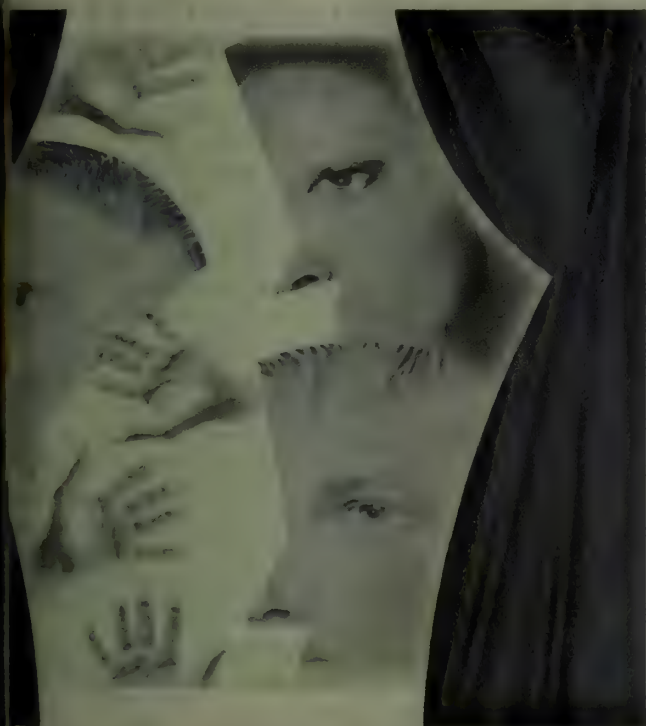
Here are steps you can take to keep your broker's interest:

CONSOLIDATE ACCOUNTS If you have accounts at different brokerages, consolidate them at one. The greater balance will increase your clout and should get you more personalized attention.

REFER FRIENDS AND FAMILY Brokers pay more attention to small investors who send business their way.

SAY THERE'S MORE TO COME Brokers also judge clients by their potential. So when you sign up, mention your prospects. Perhaps you have options in a successful company or you stand to inherit substantial sums.

PICK A BROKER WHO CATERS TO SMALLER ACCOUNTS Interview brokers at several firms. Ask how often you can expect to meet with them in person and talk to them over the phone.



nationwide. Edward Jones, also based in St. Louis, has 7,507 offices nationwide, nearly all of them one-person operations. Charleston, S.C., and its suburbs, for example, have 36 such offices.

Financial planners can provide the kind of counseling you may have once received from a broker. A planner is a good choice if you want to map out an overall investment plan and build a portfolio of mutual funds. Active stock investors may want to stay with a large brokerage because of its equity research and wide ar-



A financial planner, a regional brokerage, or even a Schwab branch office can offer the hand-holding your broker used to provide

fish at a call center," says Chip Roame, a principal at brokerage consulting firm Tiburon Strategic Advisors in Tiburon, Calif.

To make its call center less impersonal, Merrill Lynch assigns a team of seven brokers—several of whom have expertise in different areas—to an investor whose account is in the \$50,000 to \$100,000 range. If you're in this category, you can call the team directly and re-

broker to review their investment portfolio a very comfortable process," says Todd Stein, 42, an entrepreneur who lives in Arlington, Va. Ottenstein says he checks in about once a week with Merrill call-center broker John Ottenstein. Financial Advisory Center employs more than 300 brokers in Jacksonville, Fla., and Hoboken, N.J., who field more than 5,000 calls around the clock each day.

At Merrill, you don't automatically leave the call center and get your broker if your account jumps above \$100,000. Sieg says that if your investment needs remain simple even as your account balance grows, you might stay at the call center. At Prudential, on the other hand, you have the option of going back to a broker when your account balance rises above \$25,000.

quest the member who has the particular expertise you need, such as college-savings programs or retirement plans.

Clients with less than \$50,000 talk to whichever team happens to be on duty. But Andy Sieg, head of Merrill's Financial Advisory Center, says the broker who answers the phone has access to a computerized log of past calls, allowing for some continuity. In addition, clients with at least \$20,000 get two unsolicited calls a year from a

Sure, it's nice to have a local broker who knows to ask about your kid's Little League team. But in the end, it's more important to have access to the advice and services you need when you need them—even if your account isn't in the major leagues.

HOW TO BREAK UP WITH YOUR BROKERAGE

BY BRIAN HINDO

Why stick with a brokerage firm that ignores you or isn't otherwise meeting your investing needs? An automated account transfer process makes switching firms easier than you might think.

Once you decide which firm you want to move to, the new broker—the "receiving firm," in industry parlance—will send you a form from the Automated Customer Account Transfer Service, a system run by the National Securities Clearing Corp. that all NYSE and NASD member firms are required to use. The form asks for details about the brokerage account you're planning to move. Once you have completed the form and sent it back to the receiving firm, the new broker will open an account in your name and send a request to your current brokerage—the "carrying firm"—to transfer the account.

The carrying firm has three business days to approve the transfer, according to the ACATS system. The carrying firm should rubber-stamp the transfer unless your account is in arrears or it discovers an error in the paperwork.

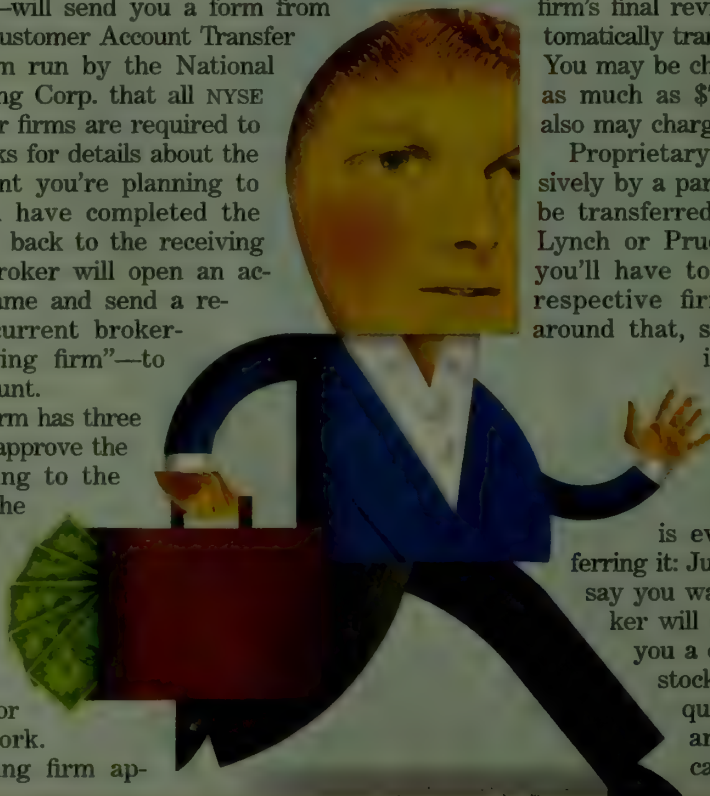
Once the carrying firm ap-

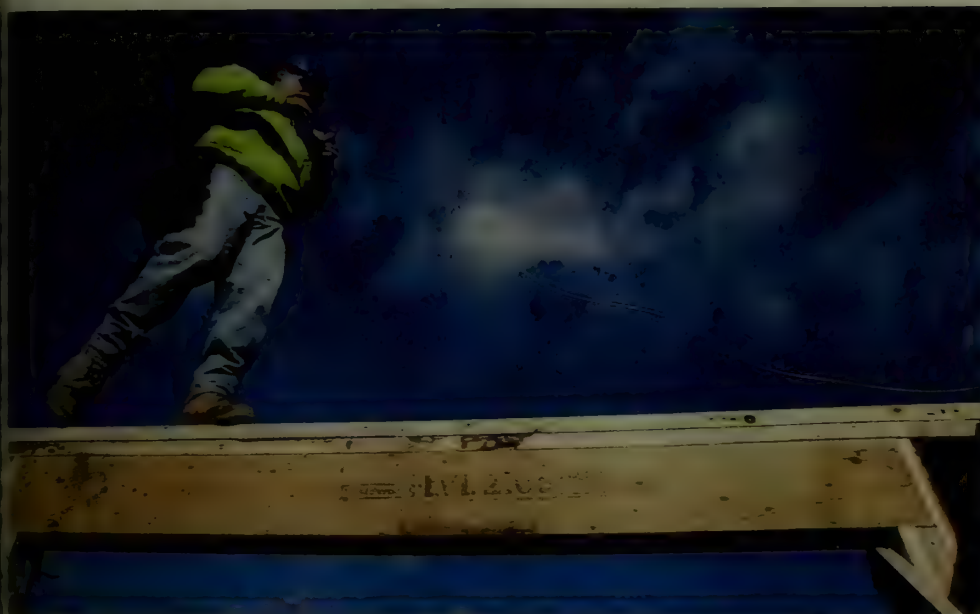
proves, the receiving firm has one day to complete the transaction, making sure it meets industry standards. Some brokerages won't accept transfers of stock securities, such as commodities or options, if your account carries outstanding fees or if the receiving firm will likely reject the transfer.

Provided your account passes the receiving firm's final review, the assets will be automatically transferred after two business days. You may be charged a transfer fee as much as \$75; the receiving firm also may charge a like fee.

Proprietary funds offered exclusively by a particular brokerage cannot be transferred. If you have mutual funds with Merrill Lynch or Prudential mutual funds, you'll have to keep them at their respective firms. There's no problem around that, short of cashing out. That could have investment and tax implications if you don't sell just for convenience. Closing your account is even easier than

ferring it: Just call your broker and say you want to do so. Your broker will sell the stocks in your account, give you a check, or else send you stock certificates if you request them. For a fee of around \$50 per account, of course.





Build It, and Tax Breaks Will Come

Low-income housing partnerships can pay off

AROL MARIE
PER

If investing in low-income housing makes you imagine constant repairs and past-due rent, envision this instead: tax credits you can subtract from the bottom line you would otherwise owe Uncle Sam. That's because this tax-credit program comes from a law designed to encourage the construction and renovation of housing for low-income families.

An investor who puts \$10,000 into a limited partnership that participates in the program could wind up with, say, a \$1,000 annual federal tax credit, depending on how effectively the partnership is set up and run. The credits continue for 10 years and in some cases add up to more than the original investment. On top of that, investors that have income from other passive activities as well (such as limited partnerships that own Thoroughbreds or oil wells) may be able to deduct the operating losses from the low-income housing partnership to lower their taxable income. That would yield them still more savings.

In order to comply with federal requirements, the partnerships are designed to last 15 years. After that, the groups can sell the projects and distribute proceeds to investors. If there is a profit, partners qualify for the new, 18% long-term capital-gains rate.

Long-term results for these risky investments are still unknown. The first ones started in 1988 and have not yet run through the 15-year holding period. And there is a track record on the tax

MASSACHUSETTS PROJECT:

Partnerships must last 15 years

credits. Consider the syndicator Boston Capital, which was among the first to begin selling low-income housing partnerships. Marketed through brokers and financial planners, the 14 partnerships launched in the first five years of the program have paid out tax credits of more than 100% of the original investment—a few of them over 140%.

Right now, Boston Capital executives say they are shooting for a 95% to 102% return of investor capital via the tax credits in their new partnerships. "If that's all that comes to you," notes Joseph Votava, a tax attorney and financial planner in Rochester, N.Y., "that's not really a good place to be." But you may also get money back through the sale of the property down the road. Some syndicators point to a national shortage of low-income housing to argue the partnerships could return the money invested, plus appreciation. But Jenny Netzer, a managing director at Lend Lease, a company that sells such partnerships to institutional investors, cautions against expecting any proceeds from a sale.

If you're considering this sort of investment, first decide whether you can tie up your money for 15 years. Selling out before the partnership ends could be difficult and costly. Then, consult a tax professional to see if you would actually be able to use the credits—and in what amount. A tax credit is worthless unless you have taxes to subtract it from. Plus, the Internal Revenue Service limits taxpayers to an amount equal to \$25,000 times their tax rate in credits each year. Someone in the 30% bracket, for example, could take up to \$7,500 of credits, although unused credits can be carried forward to later years. You also need to make sure you won't be subject to the alternative minimum tax, which doesn't honor these credits.

You have to research this investment the same as you would any other, paying special attention to fees. With Boston Capital's partnerships, you pay a 7% sales commission plus annual fees for managing the properties and the partnership itself. There's not much price competition in this niche market, as most of the other syndicators are regional firms offering the investments through private placements. Boston Capital partnerships are sold nationally, and the portfolios are geographically diversified (800 866-2282, www.bostoncapital.com).

Finally, what kind of reputation do the developers and property managers have? Look for experienced firms that know how to keep projects from falling out of compliance with the myriad government rules. Otherwise, you'll lose that juicy credit and have to pay—you guessed it—taxes. ■

Long-term results
not known, but
record so far
good: One
syndicator has
paid out tax
credits of more
than 100% of the
original investment

Super-Safe Without Being Stingy

Yields on money-market funds or CDs needn't be 1.5%

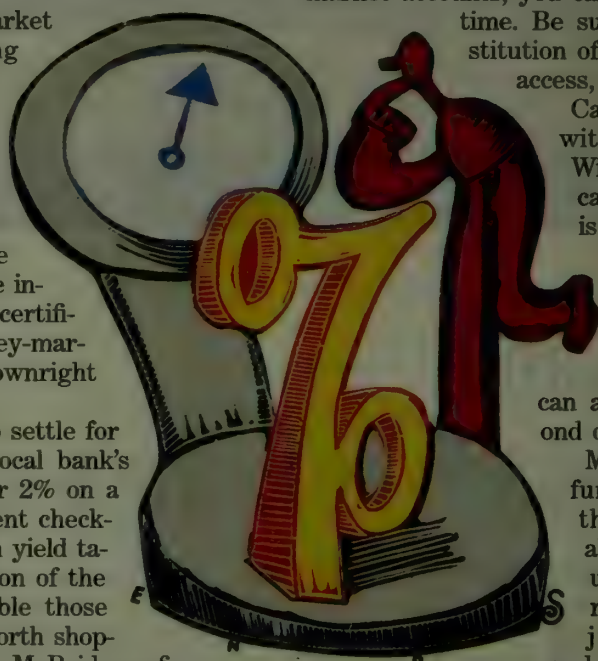
BY CAROL MARIE CROPPER

Most money-market funds are not insured; stick to brand-name fund managers, and beware of offerings that seem too good to be true

Maybe the stock market got too unnerving for you. Or you soon will be closing on a house or need to send off a fat tuition check in August. You have to park this earmarked cash in a safe place—yet returns on safe investments, such as bank certificates of deposit and money-market mutual funds, are downright microscopic.

Still, you don't have to settle for the 1.5% paid on your local bank's money-market account or 2% on a CD. With a little time spent checking out Web sites or even yield tables in the financial section of the newspaper, you can double those returns. "It's definitely worth shopping around," says Greg McBride, a financial analyst at Bankrate.com, a site that tracks interest-bearing accounts.

You can shop for the highest yields on bank CDs and money-market accounts at such Web sites as Bankrate.com and Quicken.com. At Bankrate, for instance, you can search by product and maturity, and you can look at either rates in your area or the top rates in the country. If you live in, say, Chicago, you'll find the Harris Trust & Savings Bank offers a scant 1.2% on a six-



Why is there such a wide range in CD? Your local bank may be flush with deposits out a lot of lending opportunities, and really looking for the business. Institutions else might offer higher rates because they want to cumulate deposits or figure they can still make a nice enough profit lending out the money. why, even though the national average yield on money-market accounts was recently 1.11%, the top-paying bank, ING Direct—a U.S. subsidiary of Dutch financial company ING Group—pays 3.5%. With money-market accounts, you can get your cash

time. Be sure any out-of-town institution offers check-writing access, and wire transfer

Can you get higher yields without greater risk? With bank products, yes—as long as the account is insured by the FDIC.

Deposit Insurance

Corp. You're covered on the first \$100,000

If you have money to stash, you can always put it in a second or third institution.

Money-market

funds vary far in their yields. The

all invest in similar securities—Treasury

repurchase agreements, jumbo bank

and commercial paper.

there's not much they can do to boost the rate, other than lower or waive expenses.

You can look for money-market funds on fund company Web sites or, better yet, iMoneyNet.com, which collects data from hundreds of fund companies. Here, yields averaged 1.47% as of Jan. 29—higher than those offered by the average bank. But the top performer, Dreyfus BASIC, paid much less than the best-performing bank money market.

You can hike your yield a bit by switching to a no-frills account such as Dreyfus BASIC or Dreyfus Market Fund. Large fund companies offer an alternative with less generous writing privileges but higher minimum investments and higher yields, says Patricia Lau, director of taxable money-market trading at Dreyfus. Some funds simply reduce fees to prove returns.

Beware of funds yielding significantly less than others. Unless a fund has lower fees, the difference probably comes from holding lower-quality debt. Remember, money-market funds are generally not insured (although a fund has its own default insurance), so stick to funds managed by a brand-name company you trust.

You're not going to make a fortune in conservative instruments. But at least you can get the highest possible yields in a low-interest-rate environment.

Don't Settle for Puny Returns

PRODUCT	AVERAGE YIELD	TOP YIELDS	INSTITUTION
6-MONTH CD	1.80%	3.02%	DeepGreen Bank (888 576-9238)
		3.00	interState NetBank (866 476-2265)
		2.96	GiantBank.com (877 446-4200)
1-YEAR CD	2.71	3.41	DeepGreen Bank (888 576-9238)
		3.40	Countrywide Bank (877 292-2655)
		3.36	NetBank (888 256-6932)
BANK	1.11	3.50	ING Direct (800 464-3473)
MONEY-MARKET		3.45	Central Bank (229 937-5009)
ACCOUNT		3.10	Capital One FSB (800 564-7426)
MONEY-MARKET	1.47	2.09	Dreyfus BASIC (800 782-6620)
MUTUAL FUND		2.09	Touchstone (800 543-8721)
		2.04	Bunker Hill (800 572-9336)

Yields as of Jan. 29, 30

Source: Bankrate.com, iMoneyNet

month CD as of Jan. 30. Neighboring LaSalle Bank is a little better, with a 1.7% rate on the same CD. But the Web allows you to cast a nationwide net. The top yield in the country is Deepgreen Bank in Cleveland, with an annual percentage yield of 3.02%. Repeat the same process to research a slew of other bank products, and you also can find national averages.



You listen to an e-mail on your cellphone. So you save valuable time when on the road. It's possible when Avaya transforms your company's voice and data systems by getting them working together. Reliably. Securely. With our innovations in voice and in-depth expertise in data, efficiency becomes the rule, not the exception. Find out why more than 90% of the FORTUNE 500® use Avaya communications to power their business, visit avaya.com/nowone.

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COMMUNICATION WITHOUT BOUNDARIES

PROGRESS? NOT AS MUCH AS YOU THOUGHT



BY TODDI GUTNER

hers@businessweek.com

A new report shows that women are still far from equal in nearly every measure of corporate success

SLOW GOING FOR WOMEN IN BUSINESS

The C200 Business Leadership Index 2002 measures the progress of women compared with men in 10 areas. A score of 10 indicates parity.

WAGES	7.60
MBA ENROLLMENT	6.60
BUSINESS OWNERSHIP	5.88
LINE/STAFF RATIO*	5.60
KEYNOTE SPEAKERS	3.88
COMPANY SIZE	3.25
CORPORATE OFFICERS	2.78
CORPORATE BOARD SEATS	2.66
VENTURE CAPITAL	1.10
CHARITY FUND-RAISING CHAIRS	0.00
AVERAGE	3.95

* Line positions have profit-and-loss responsibility. Staff jobs provide support for line positions.

Data: The Committee of 200 Annual Report on Women's Clout in Business

The Committee of 200 (C200) is one of the most prestigious business organizations you may never have heard of. This 20-year-old network of women entrepreneurs and corporate leaders now has 441 members, including Ogilvy & Mather Chairman Shelly Lazarus and Heidi Miller, vice-chairman of insurance broker Marsh Inc. and former chief financial officer of Citigroup. It has a tough membership requirement: Women must own companies that earn at least \$15 million in annual sales or be corporate executives who head companies or divisions with annual revenues of at least \$250 million.

The organization at first functioned mainly as a support network. But under the direction of C200's president, Anna Lloyd, it has broadened its goals in the past five years to helping the next generation of businesswomen by providing MBA scholarships and mentoring programs. Now, C200 wants to make sure women's progress in the business world remains in the public eye.

C200 hired a quantitative research firm, which relied on public and proprietary data from such sources as the U.S. Census Bureau to devise the C200 Business Leadership Index. It measures how businesswomen are faring in relation to their male

counterparts. Researchers used data from 10 key areas to come up with a benchmark number for each category, based on a 10-point scale. The 10 scores were then tallied into an overall index.

C200 envisions turning the index, which appears publicly for the first time in *BusinessWeek*, into an annual report card (table). The initial results are eye-opening. With 10 equaling parity with men, the overall index number was a mere 3.95 (table). A lot of the evidence about women's progress has been anecdotal, says Connie Duckworth, chairman of C200 and a retired Goldman Sachs partner who now invests in startups. "The hard numbers reported in the study are a good wake-up call that we hope will start a dialogue about women's progress in senior-level positions."

There's a lot to talk about. The highest score, 7.6, is for women's earnings compared with men's. In part, that's because equal pay for equal work has been a goal of public policy for decades. Nevertheless, it will take 30 more years to reach parity at the current pace of progress.

One of the index's strong points is

that it provides an overview of women's success in business, but also highlights where the weaknesses are. The overall index was so low because it did poorly in three categories: charity fund-raising chairs (0), venture-capital funding (1.1), and corporate board seats (2.66).

I asked some C200 members for ideas on how to improve these scores. In the fund-raising arena, for example, women don't chair as many important events put on by the top 30 U.S. companies. That's because women aren't perceived as well-connected as men when it comes



DUCKWORTH: "Hard numbers" should spark discussion

enriching corporate purse strings, says the report. Marcy Syms, CEO of discount retailer Target, says if the top charities don't put women front and center, women will use their considerable clout to support their own network of worthy causes, as they're already doing with groups such as the Ms. Foundation.

As for women's minimal access to venture capital funds, Agnieszka Winkler, an entrepreneur, takes the long view. "We need to foster interest in math and science among girls," she says, so that more will gravitate toward high-tech industries, a venture-capitalist haven.

Many boards are desperate for women. Yet even with more women in the executive ranks, they often aren't selected to fill board seats. The problem is that many boards consider women who aren't CEOs, says Duckworth. "Boards must broaden their parameters beyond the traditional list of appointees to CFOs and vision heads, and that, in turn, can infuse the system with new people and fresh ideas. We hope the index generates the discussion to speed that infusion."

BusinessWeek online

To join a discussion in our forum, see hers on www.businessweek.com/investor/

It's not just e-Business. It's Real Business.



COMPANY

Edmunds - www.edmunds.com - "Where Smart Car Buyers Start®"

BEST KNOWN FOR

The most comprehensive and impartial automotive information

BUSINESS PHILOSOPHY

When you're buying a car, what you don't know can hurt you

DEFINING INTERNET MOMENT

When syndication partners increased our traffic tenfold

RESULTS

The Edmunds brand has been serving car-shoppers for more than 35 years, and Digex has been managing Edmunds.com's Web site for more than five years.

In 1994, Edmunds.com became the first company to provide consumer automotive information on the Internet by posting its vehicle pricing on an Internet Gopher site.

In 2000, Edmunds became the first source of vehicle data for users of wireless Web-enabled devices. Today, hundreds of Web sites, including the world's three largest portals, use Edmunds.com's syndicated content to educate car-shoppers.

Digex provides full management of the Edmunds.com Web site so they can focus on their mission: empowering the automotive consumer.

To learn how Digex can empower your site, call **1.866.344.3997** or visit **www.digex.com/hosting**.



Managing Business on the InternetSM

KEEPING WATCH ON FUND WATCHDOGS



BY ROBERT BARKER

rb@businessweek.com

Knowing where to get a real explanation when something goes awry with your mutual fund can be as mysterious as Stonehenge. Suppose you've learned the fund bought shares of Enron last summer, and you want to know why. The stars of the show, portfolio managers, aren't paid to talk directly to investors and rarely do. The grunts, customer service reps, respond with little more than scripted spiels. And the bosses, fund company execs, owe their first duty to the investment firm. Only after that do they serve you, the fund's actual owner.

So just who is answerable to you? It's an obscure group of people known as the fund's independent directors, who from now on will find themselves under a new spotlight. The Securities & Exchange Commission on Jan. 31 put into effect a set of rules that demand more disclosure from directors, including how much they have invested in the funds they oversee, their conflicts of interest, and their rationale for approving a manage-



ment contract that costs stay down. Investors at least get what they pay for. They don't always search. Morningstar's database for domestic stock funds that returned below-average returns over the five years ended Dec. 31, 2000, charged above-average expenses. The fund found 77 funds, including plenty from hedge file families such as Alliance, Oppenheimer, and Van Wagoner.

Consider a specific case, Alliance Quasar. Since 1997, it returned 0.17% a year on average, leaving it among the worst 11% of comparable funds, according to Morningstar. Performance over other periods also was dim. Yet Quasar's pay a premium price—1.67% of assets in expenses, vs. the average 1.42%. It's as if you're charged for sirloin and get tripe. Edmund Jr., general counsel to Alliance funds, didn't turn my call for comment.

In the end, though, it's not Alliance responsible. It's the fund's six independent directors, whom Alliance's fund holders paid an average of \$186,432 for oversight over an average of 38 Alliance funds, including Quasar (which paid the six an average of \$4,211). They are concerned and we are working hard. Quasar independent director William F. a Greenwich (Conn.) investment adviser has more than \$100,000 of his own money in Alliance funds. "We won't let up." He adds, "Directors will take a close look at Quasar's performance and fees in July when Alliance's contract comes up for renewal."

Under the SEC's new disclosure rules, if directors approve another contract with the fund for investment advice, they will have to disclose to the fund's owners, in the Statement of Additional Information, why the deal is sound. Ditto for groups of independent directors. With a close look on them, some of the fund world's darkest secrets will be harder to hide.

Will this fuller, more conspicuous disclosure make funds wondrously better investment vehicles? Don't count on it. Most investors will neither notice nor care. But I do think the new rules will help some investors enlist

directors in solving problems, while also aging lackadaisical directors to supervise funds' investment advisers more closely. It charges independent directors (or trustees they're sometimes known) with looking out only for investors' interests. Trouble is, hardly any investors know that. To those who do, independent directors too often have seemed to side with investment advisers—whom they are supposed to supervise—over investors.

Focusing on Oversight

New rules require more disclosure about the independent directors who are supposed to serve as the fund investors' watchdogs. Here's what you can learn about them and where to find it:

	ANNUAL REPORT	PROXY STATEMENT*	STATEMENT OF ADD'L INFO.**
NAME, AGE, ADDRESS	✓	✓	✓
PRINCIPAL OCCUPATION	✓	✓	✓
CURRENT TERM AND TENURE SERVED	✓	✓	✓
NUMBER OF PORTFOLIOS OVERSEEN	✓	✓	✓
OTHER OUTSIDE DIRECTORSHIPS	✓	✓	✓
HOLDINGS IN EACH FUND OVERSEEN		✓	✓
AGGREGATE HOLDINGS IN FUND FAMILY		✓	✓
CONFLICTS OF INTEREST		✓	✓
BASIS FOR APPROVING FUND ADVISER'S CONTRACT			✓

*Disclosures only required in proxies discussing election of directors

**Filed annually, available on request

Data: Securities & Exchange Commission

BusinessWeek online

For barker.online, go to
www.businessweek.com/investor/ and click on "

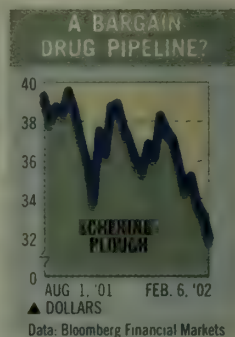
POOLING OF PILLS



Gene G. Marcial

...needing a
lockbuster,
...eyeing
...ing. Olstein
...an oil driller
...eeps a low
...e. And GE's
...could be
...s' gains

Last year's speculation that Schering-Plough (SGP) may end up in Merck's arms is back. Now that Merck has decided to spin off Medco, its pharmacy-benefits management unit, and refocus entirely on drugmaking, it will have to do a big acquisition to bolster its product pipeline, say analysts. Merck is already in partnership with Schering. They're developing a cholesterol-lowering drug that will combine in one pill Merck's existing Zocor product with Schering's Zetia to compete effectively with Pfizer's top-selling drug, Lipitor. Merck's Zocor, with sales of nearly \$7 billion in 2001, accounts for one-fourth of Merck's total net income. But its patent expires in 2005, while Schering's patent for Zetia lasts until 2014—which would extend to the combined Zocor/Zetia product. "Acquiring Schering would be a very smart move for Merck," argues Richard Evans of Sanford C. Bernstein Research. Merck needs to add products either approved or near approval to bolster sales in the very near term, he says. Buying Schering "is the best means to achieve this end," says Evans, because it would then reap 100%—rather than just 50%—of profits from the Zocor/Zetia drug. Evans notes that buying Schering would be similar to Pfizer's purchase of Warner-Lambert in 2000 to get Lipitor. He figures Merck could pay 0.71 Merck shares for each Schering share, or 42 a share, about \$11 above the current price. Merck declined comment. Schering didn't return calls.



HIDDEN RICHES IN DRILLER ROWAN

With Enron and other potential Enrons spooking Wall Street, Bob Olstein of the Olstein Financial Alert Fund is looking behind the numbers—not to uncover more accounting fiascos but to discover undervalued gems. He may have found one in Rowan (RDC), a major global contract oil and gas driller and maker of offshore drilling rigs and heavy gear. Rowan's stock has skidded from 33 a share on May 21, 2001, to 17 on Feb. 6 in the aftermath of declining energy prices and the Enron debacle. Olstein says that based on the replacement value of its rigs alone, the stock is worth 25. But based on its cash flow, and projected earnings of \$2 in 2004, it's worth 35—or a p-e of 17.5. Rowan earned 80¢ a share in 2001. The consensus forecast for 2002 is 9¢ a share because of falling gas prices, and then \$1.16 in 2003 as the

economy rebounds and energy prices bounce back. But, says Olstein, earnings are understated. Rowan sells about half of the specialty rigs it manufactures to its offshore drilling division at cost, with no markup and no profit. Sure, the company does realize a profit as the rig is put into use, but that comes about through charging off less depreciation on the lower base price of the rig and is spread over the life of the rig, usually 10 years or more. Not only are its earnings understated, but its assets are also understated since they are carried on its books at manufacturing cost. Rowan also has \$80 million in deferred one-time income from a lawsuit it won against Amoco Exploration in mid-November last year.

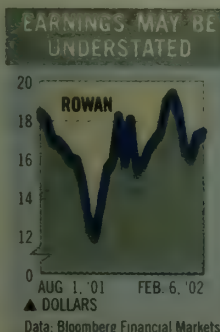
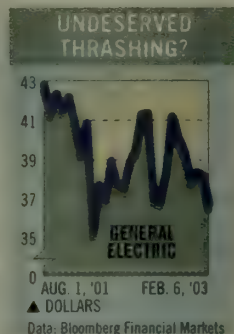
In 2001, Olstein Financial Alert Fund gained 17.25% vs. a loss of 11.82% by the S&P 500.

GE: GET IT WHILE IT'S CHEAP

Carl Domino, president of Northern Trust Value Investors, likes to buy beaten down shares of quality growth companies. He thinks General Electric (GE) now falls under that category, in part due to rumors of accounting issues that have surfaced in light of the Enron mess (page 34). Domino has taken advantage of GE's drop from 53 a share in mid-May to 36.95 on Feb. 6, 2002. "This was the first chance we got to buy GE at a steep discount," says Domino, who notes that GE is one of only a handful of companies with a triple-A-rated balance sheet. "GE is an ironclad, blue-chip growth company that isn't being valued as such," he says. Adds David Roberts, a Northern Trust Value analyst who tracks GE: "With the witch-hunt going on for other Enrons, GE has been beaten down unjustifiably, since there isn't any evidence that an accounting problem exists." At 36, GE is trading at 21 times estimated 2002 earnings of \$1.65 a share. It is cheap based on its history of earnings growth, sales, cash flow, and balance-sheet measures, says Roberts. GE CEO Jeffrey Immelt on Feb. 5 reaffirmed his profit forecast of a 17% to 18% earnings leap in 2002, to from \$1.65 to \$1.67—well within analysts' estimates as surveyed by Thomson Financial/First Call. Roberts' 12-month GE price target: 47.



OLSTEIN: 2001 was a good year



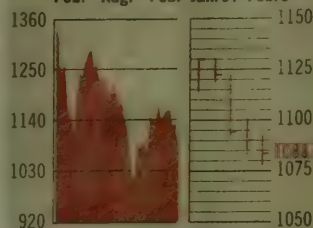
BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:30 p.m. EST on CNNfn's *The Money Gang*.

Stocks

S&P 500

Feb. Aug. Feb. Jan. 31-Feb. 6



COMMENTARY

News of improving factory orders in some regions sent stocks briefly higher early in the week, but it was downhill from there as investors ignored good news on productivity and focused on future profits. Not even positive words by GE's CEO halted the slide. For the week, the Dow Jones industrial average, the S&P 500, and Nasdaq fell 1.1%, 2.7%, and 5.3%, respectively.

Data: Bloomberg Financial Markets, Bridge Information Systems, Inc.

U.S. MARKETS

	Feb. 6	Week	Year to date	Last 12 months
S&P 500	1083.5	-2.7	-5.6	-19.9
Dow Jones Industrials	9653.4	-1.1	-3.7	-11.9
Nasdaq Composite	1812.7	-5.3	-7.1	-32.0
S&P MidCap 400	489.0	-2.9	-3.8	-7.0
S&P SmallCap 600	224.1	-2.9	-3.5	-2.3
Wilshire 5000	10,132.4	-2.8	-5.4	-18.8

SECTORS

	Feb. 6	Week	Year to date	Last 12 months
BusinessWeek 50*	656.0	-5.0	-10.1	-35.9
BusinessWeek Info Tech 100**	381.5	-4.4	-9.0	-38.4
S&P/BARRA Growth	576.3	-1.6	-3.1	-17.2
S&P/BARRA Value	507.2	-3.8	-8.1	-23.0
S&P Energy	205.6	0.7	-2.7	-13.8
S&P Financials	328.2	-4.3	-7.6	-16.3
S&P REIT	93.1	-0.3	-0.3	6.5
S&P Transportation	204.1	-1.6	3.6	-1.7
S&P Utilities	131.0	-2.9	-10.2	-33.9
GST Internet	84.8	-14.2	-19.2	-58.9
PSE Technology	651.9	-3.7	-5.2	-26.1

*Mar. 19, 1999=1000

**Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Gold Mining	12.5	Metal & Glass Containers 66.4
Food Wholesalers	11.0	Gold Mining 44.0
Trucking	8.7	Trading Cos. & Distribs. 39.4
Tobacco	7.9	Office Electronics 29.2
Office Electronics	6.9	Trucking 28.5

GLOBAL MARKETS

	Feb. 6	Week
S&P Euro Plus (U.S. Dollar)	982.6	-2.4
London (FT-SE 100)	5073.8	-0.3
Paris (CAC 40)	4273.8	-3.0
Frankfurt (DAX)	4804.4	-4.9
Tokyo (NIKKEI 225)	9420.9	-5.0
Hong Kong (Hang Seng)	10,592.4	-1.5
Toronto (TSE 300)	7497.1	-0.7
Mexico City (IPC)	6786.7	-0.1

FUNDAMENTALS

	Feb. 5
S&P 500 Dividend Yield	1.43%
S&P 500 P/E Ratio (Trailing 12 mos.)	59.0
S&P 500 P/E Ratio (Next 12 mos.)*	20.5
First Call Earnings Surprise*	1.41%

*First Call Corp.

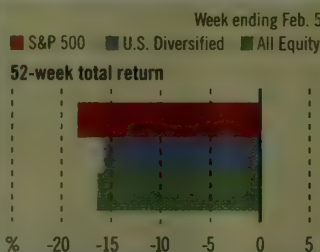
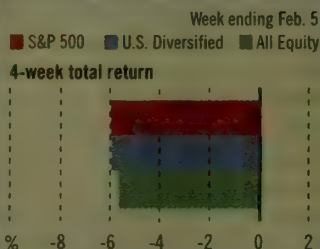
TECHNICAL INDICATORS

	Feb. 5
S&P 500 200-day average	1165.0
Stocks above 200-day average	55.0%
Options: Put/call ratio	0.77
Insiders: Vickers Sell/buy ratio	2.74

WORST-PERFORMING GROUPS

	Last month %
Wireless Services	-38.5
Multi-Utilities	-32.0
Telecomms. Equip.	-24.9
Instrumentation	-22.4
Environmental Services	-20.2

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return %	52-week total return %
Leaders	Leaders
Precious Metals 20.0	Precious Metals 47.9
Real Estate -0.1	Real Estate 9.5
Diversified Emerging Mkts. -2.0	Small-cap Value 6.6
Pacific/Asia ex-Japan -2.9	Mid-cap Value -0.3
Laggards	Laggards
Communications -16.9	Communications -48.0
Technology -13.2	Technology -43.0
Japan -11.6	Japan -36.1
Utilities -8.0	Large-cap Growth -26.3

EQUITY FUNDS

4-week total return %	52-week total return %
Leaders	Leaders
First Eagle SoGen Gold 27.4	CGM Focus 83.4
U.S. Global Investors Gold 27.4	First Eagle SoGen Gold 79.1
US Glob. Inv. World Gold 27.2	Am. Cent. Glob. Gold Inv. 74.1
Rydex Dynamic Vent. 100 27.1	Monterey OCM Gold 71.7
Laggards	Laggards
Potomac Internet Plus -29.0	ProFunds UltraOTC Inv. -74.9
Fidelity Select Wireless -26.3	Black Oak Emerging Tech. -71.4
ProFunds UltraOTC Inv. -24.3	Berkshire Focus -71.2
Black Oak Emerging Tech. -23.7	Merrill Lynch Focus 20 B -70.9

Interest Rates

KEY RATES

	Feb. 6	Week
MONEY MARKET FUNDS	1.63%	1.6
90-DAY TREASURY BILLS	1.73	1.7
2-YEAR TREASURY NOTES	2.95	3.0
10-YEAR TREASURY NOTES	4.92	5.0
30-YEAR TREASURY BONDS	5.37	5.4
30-YEAR FIXED MORTGAGE†	6.81	6.8

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bor
GENERAL OBLIGATIONS	4.29%
TAXABLE EQUIVALENT	5.22
INSURED REVENUE BONDS	4.39
TAXABLE EQUIVALENT	5.36

THE WEEK AHEAD

RETAIL SALES *Wednesday, Feb. 13, 8:30 a.m. EST* ▶ Retail sales in January probably remained unchanged, based on the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies. Excluding vehicles, January sales likely rose 0.3%, after slipping 0.1% in December. Vehicle sales have fallen off with the rollback of manufacturer incentives.

BUSINESS INVENTORIES *Thursday, Feb. 14, 8:30 a.m. EST* ▶ Inventories are forecast

to have shrunk by 0.5% during December, after falling 1% in November. In early 2002, inventories are likely to fall at a slower clip or even grow in some industries after a record liquidation of \$120 billion during the fourth quarter.

EXPORT-IMPORT PRICES *Thursday, Feb. 14, 8:30 a.m. EST* ▶ Import prices probably fell 0.4%, and export prices probably slipped 0.2% during January. December import prices dropped 0.9%, and export prices inched lower by 0.2%.

PRODUCER PRICE INDEX *Friday, Feb. 15, 8:30 a.m. EST* ▶ Producer prices for finished goods probably rose 0.1% after a 0.7% drop in December. Excluding the volatile food and energy categories, core prices probably rose 0.1%, after declining 0.1% in December.

INDUSTRIAL PRODUCTION *Friday, Feb. 15, 9:15 a.m. EST* ▶ Factory output probably decreased 0.1% in January and straight month, while the utilization rate likely fell to 77%.

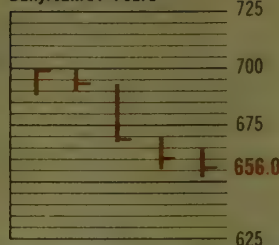
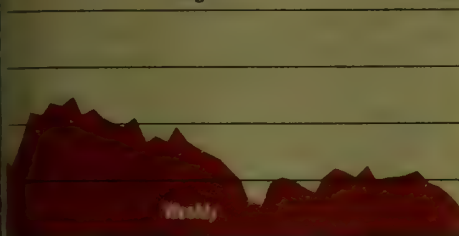
THE
BUSINESSWEEK **50**

BusinessWeek Fifty

Aug.

Feb.

Daily: Jan. 31-Feb. 6



Iron reverberated through the BW 50 as investors bolted stocks where accounting seemed questionably hard-hit was Tyco International, which plummeted 22.7% on Feb. 5, after announcing it its bank credit lines to fund short-term needs; for the week, Tyco lost 25.6%. Also stricken were Calpine and AES, dropping 38.5% and 28.5%, respectively. The BW 50 sank 5.0%.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	-25.6	-52.5	26	Verizon Communications	-5.8	-10.4
Petroleum	2.5	-24.3	27	Citigroup	-7.4	-9.6
	-38.5	-84.7	28	Sun Microsystems	-11.9	-52.2
	-10.9	-54.7	29	Merck	-0.4	-26.5
Materials	3.5	-1.5	30	El Paso	-3.7	-51.9
Financial	-21.0	-93.7	31	Altera	-9.0	-8.6
Petroleum	2.0	7.2	32	Marsh & McLennan	2.1	-4.6
	3.3	-10.0	33	Household International	-9.4	-23.4
	1.0	-18.8	34	ChevronTexaco	0.1	-4.2
Others Holdings	-3.5	-25.0	35	SBC Communications	-5.0	-24.2
	-5.7	-12.3	36	Mercury Interactive	-9.4	-40.6
	-12.1	-66.2	37	AOL Time Warner	-8.0	-44.8
	-28.5	-81.9	38	Washington Mutual	-8.1	-6.2
Utilities	-4.7	17.3	39	General Dynamics	3.1	31.1
Financial	-5.8	-24.1	40	Comcast	-9.6	-26.2
Technology	13.2	2.2	41	Morgan Stanley Dean Witter	-7.0	-23.1
	-9.6	-3.2	42	Tellabs	-11.9	-69.6
Mass	4.0	-14.7	43	Exxon Mobil	0.6	-4.4
Media	-6.2	-22.4	44	Scientific-Atlanta	-5.3	-47.2
Communications	-19.0	-63.3	45	U.S. Bancorp	-4.2	-16.1
Financial	-7.3	-20.4	46	Paychex	-2.8	-11.6
Petroleum	-0.5	8.7	47	Merrill Lynch	-8.3	-24.8
Services	-5.7	-0.5	48	Bed Bath & Beyond	-1.0	33.0
Services	-0.6	-25.1	49	Texas Instruments	-4.0	-9.0
Health	-3.4	-5.1	50	Teradyne	1.6	-2.5

Production Index

Change from last week: -0.3%
Change from last year: -11.2%

OUTPUT Jan. 26=159.2 1992=100



Index declined during the latest week. On the four-week moving average, it fell to 158.5 from 160.2. On a seasonal basis, autos and trucks posted the sharpest declines. Autos and trucks were hurt by crude-oil refining, lumber, railroad coal. Electric power was unchanged, and autos was the only component to rise. The index inched up to 158.5 from 158.2.

For more information on the index components is at www.businessweek.com.
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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. **Companies listed in italics are not included.**

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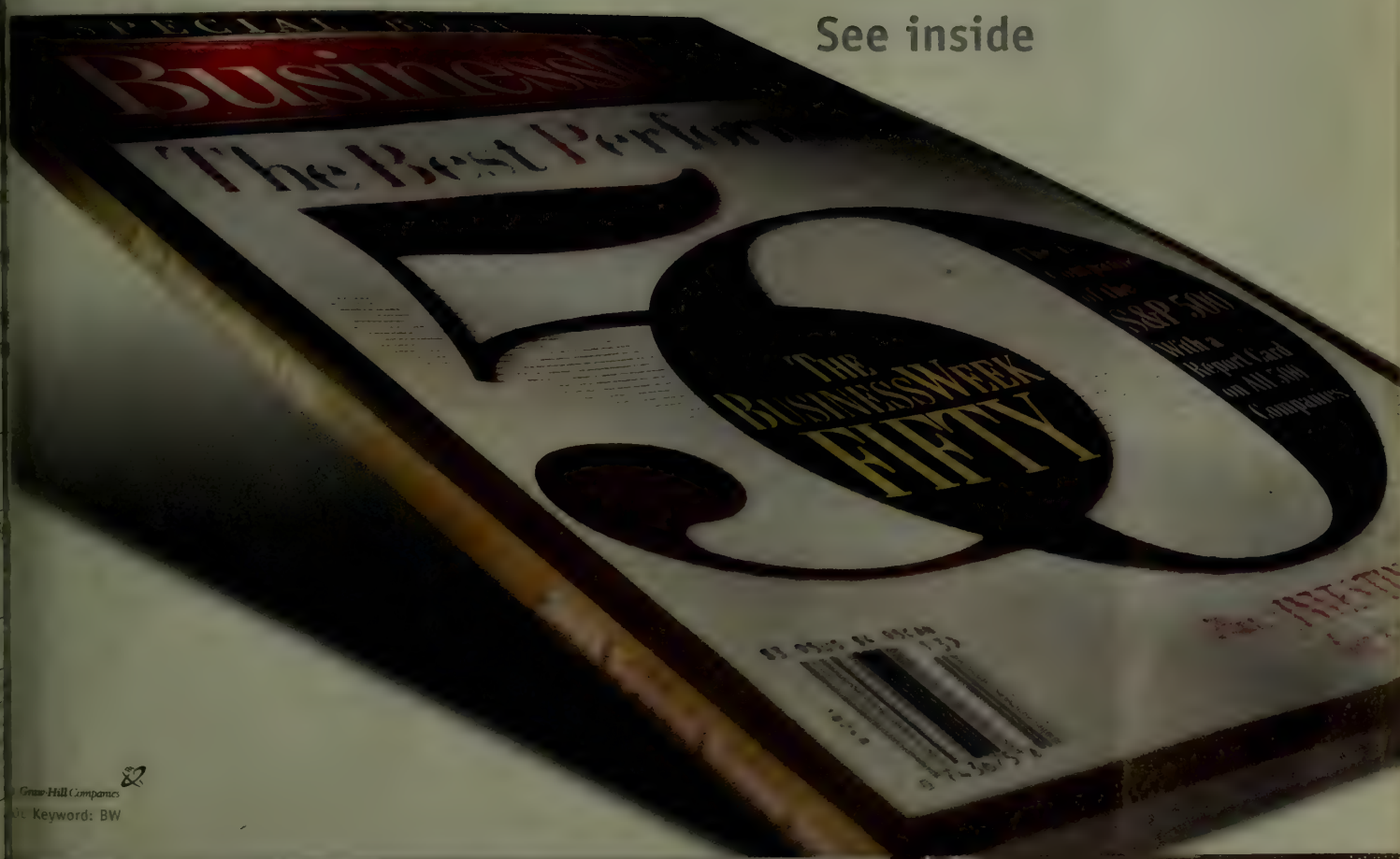
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See inside



A CLEANUP JOB FOR CORPORATE AMERICA

Investors aren't waiting for the Securities & Exchange Commission or the accounting profession to clean up Corporate America's books. Post-Enron Corp., they're taking action themselves. A huge cleansing is under way in the stock and bond markets as individuals and institutional money managers turn away from companies perceived to have flawed or opaque financial statements. Tyco International Ltd. is but one of many companies whose paper is being dumped for its accounting sins. The good news is that, under investor pressure, dozens of corporations are now scrambling to restate their earnings and make their balance sheets more transparent. The bad news is that the investor revolt could turn into a stock market rout and the growing strains on credit could produce a serious banking crisis. Policymakers and regulators would be wise to move quickly to fix what is a corrupted corporate reporting system. There is more at stake than the economic recovery. The integrity of American capitalism is at issue.

The financial markets are already showing deep strain. Corporate bonds are starting to suffer mightily as companies with questionable accounting throw a shadow over the entire bond market. Investors don't know which company will be hit next—or how hard. The commercial paper market is getting pummeled as well. When the Standard & Poor's rating agency cut Tyco by three notches in one fell swoop, it effectively shut the company out of the commercial paper market. Tyco then had to draw on its \$8 billion backup bank lines of credit. If dozens of companies are forced to follow, banks may soon face a liquidity crisis of their own. That increases the chances of a double-dip downturn.

What should be done? The Federal Reserve, of course, should be monitoring the markets to make sure there's enough liquidity to keep them open and steady. There is

every indication that it is doing its job. But not so the SEC or the auditors. It's critical for investors to regain confidence in the markets and believe that they have the tools to evaluate risk and value companies fairly. Those companies are moving back toward more conservative accounting, heading in the right direction. But a new set of accounting standards for all companies is absolutely necessary. They must include better uniform measures of true financial health: unencumbered cash flow or true operating earnings. That would get us closer to this goal. The SEC and the accounting profession must face up to their responsibilities and act forcefully.

So, too, must Corporate America. The silence of the CEOs throughout the slow death of Enron is hurting the reputation of Big Business at home and abroad. With Enron, we've seen self-dealing, the breaking of corporate codes of conduct, the buying off of professional watchdogs, the destruction of pension savings, and widespread political corruption. Congress is investigating, the President is castigating, accounting firms are changing, but CEOs are not talking. Chief executives who are usually not shy about speaking out on taxes, health care, China, or a host of other issues are silent on Enron. The Business Round Table has issued a statement basically saying it was studying the matter. The U.S. Department of Commerce and the National Association of Manufacturers have spoken mostly to defend (401)(k) pension plans in the face of Congressional efforts to reform them. What about the CEO criticism of Enron managers making tens of millions of dollars in inside, self-dealing partnerships while employees and shareholders are left stranded?

America needs its chief executives to speak out and help restore credibility to the nation's business culture. Who will be the first?

THE NUMBER TO WATCH: PRODUCTIVITY

Let's hear it for the "P" word. With accounting questions dogging earnings, debt markets swooning, and stocks under heavy pressure, it is important to recognize that the fundamental driver of all economic growth and corporate profits—productivity—is doing well. Actually, it is doing fabulously well. Productivity grew at a 3.5% rate in the fourth quarter of last year, making the annualized growth rate of the past three quarters 2.3% (page 29). Looking at past slow-downs, this is when productivity usually declines. The heated New Economy debate over whether or not the jump in productivity in the 1990s was temporary or narrowly based appears over. The gains are real, widespread, and important.

For some time, *BusinessWeek* has argued that the spread of information technologies, globalization, and venture-capital

markets were raising the rate of productivity growth, paving the way for higher sustained economic expansion. That view is now converging toward that view. At the recent Economic Forum held in New York, a consensus emerged that U.S. productivity was now growing between 2% and 2½% annually, up from the anemic 1.4% of the '70s. President Bush's latest annual economic report says that productivity growth is now 2.1% and that progress builds in a rate of 2.1% productivity growth over the long term. "The New Economy remains alive and well," says the report, prepared by the President's Council of Economic Advisers.

Timing any recovery is difficult, and this one is no different. But once it gets going, solid gains in productivity will help the economy to expand at a strong 3% over time. Let's keep that in mind during this period of uncertainty.

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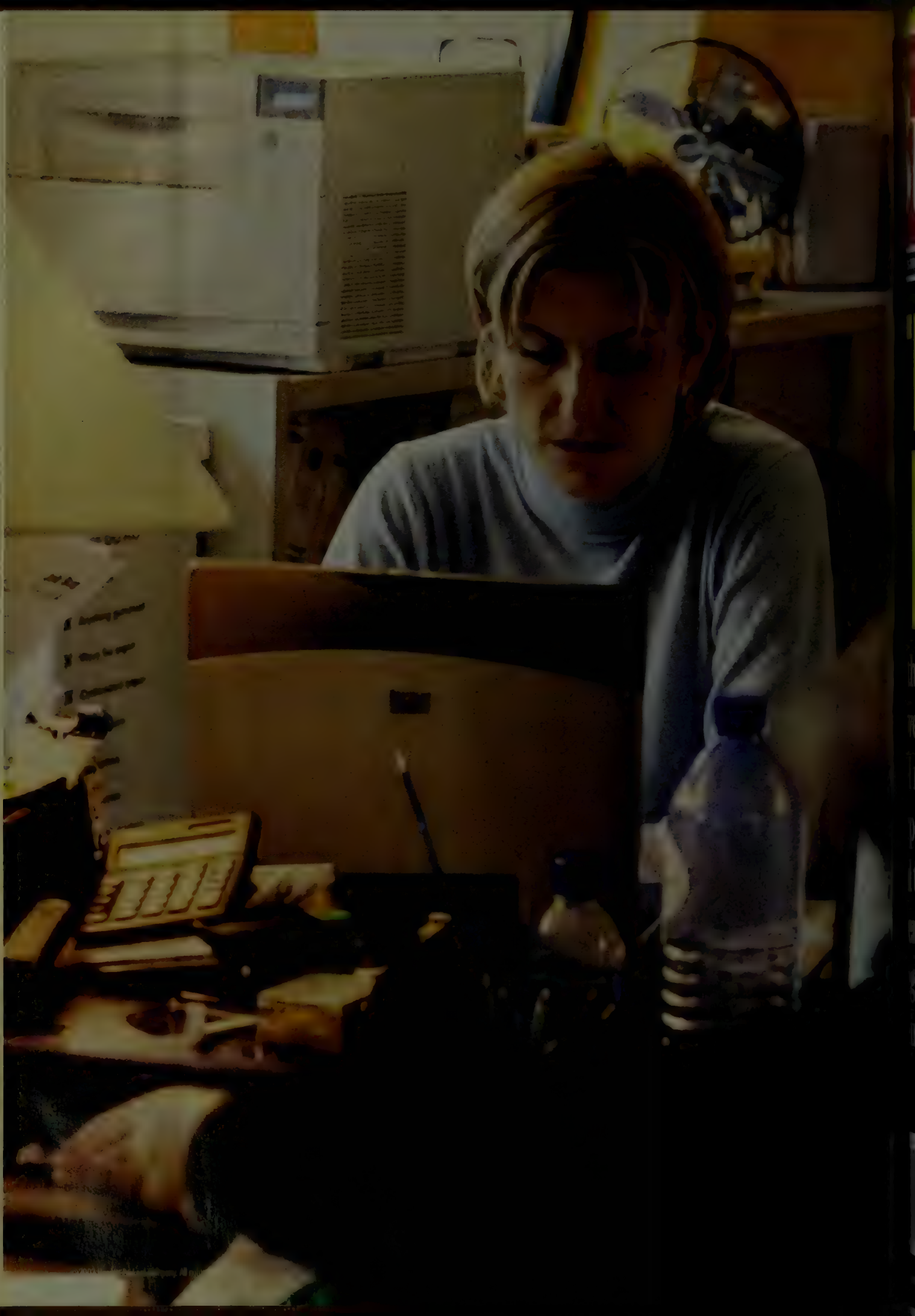
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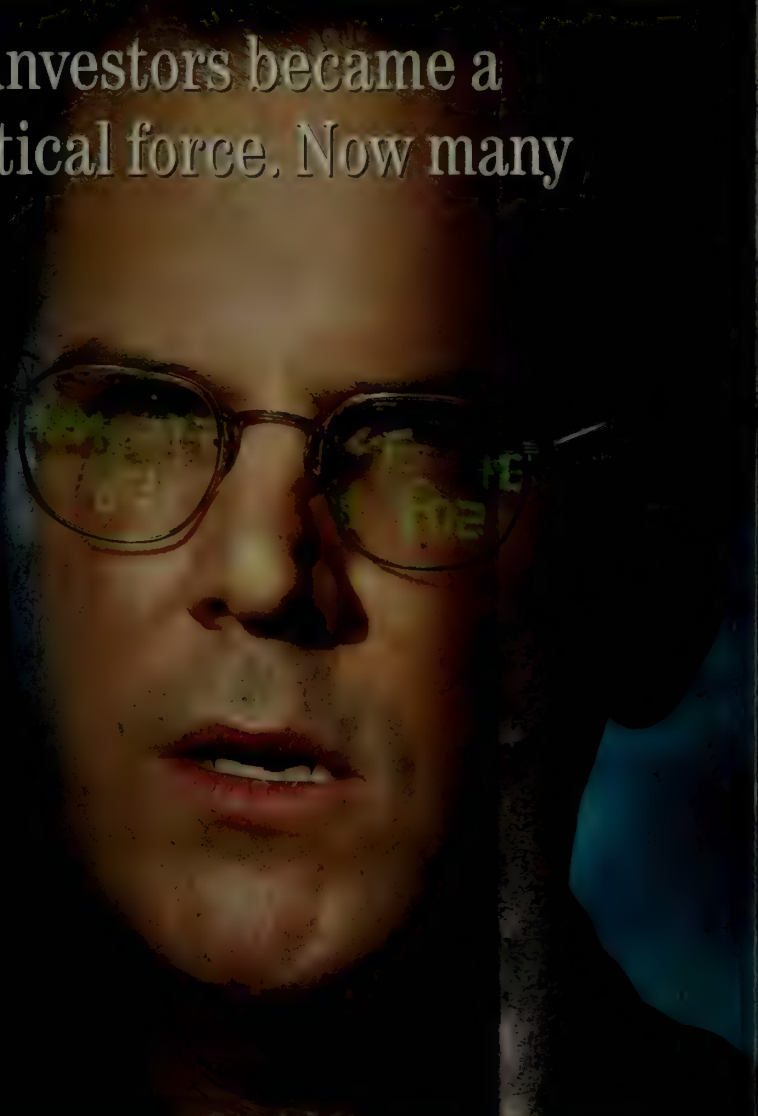
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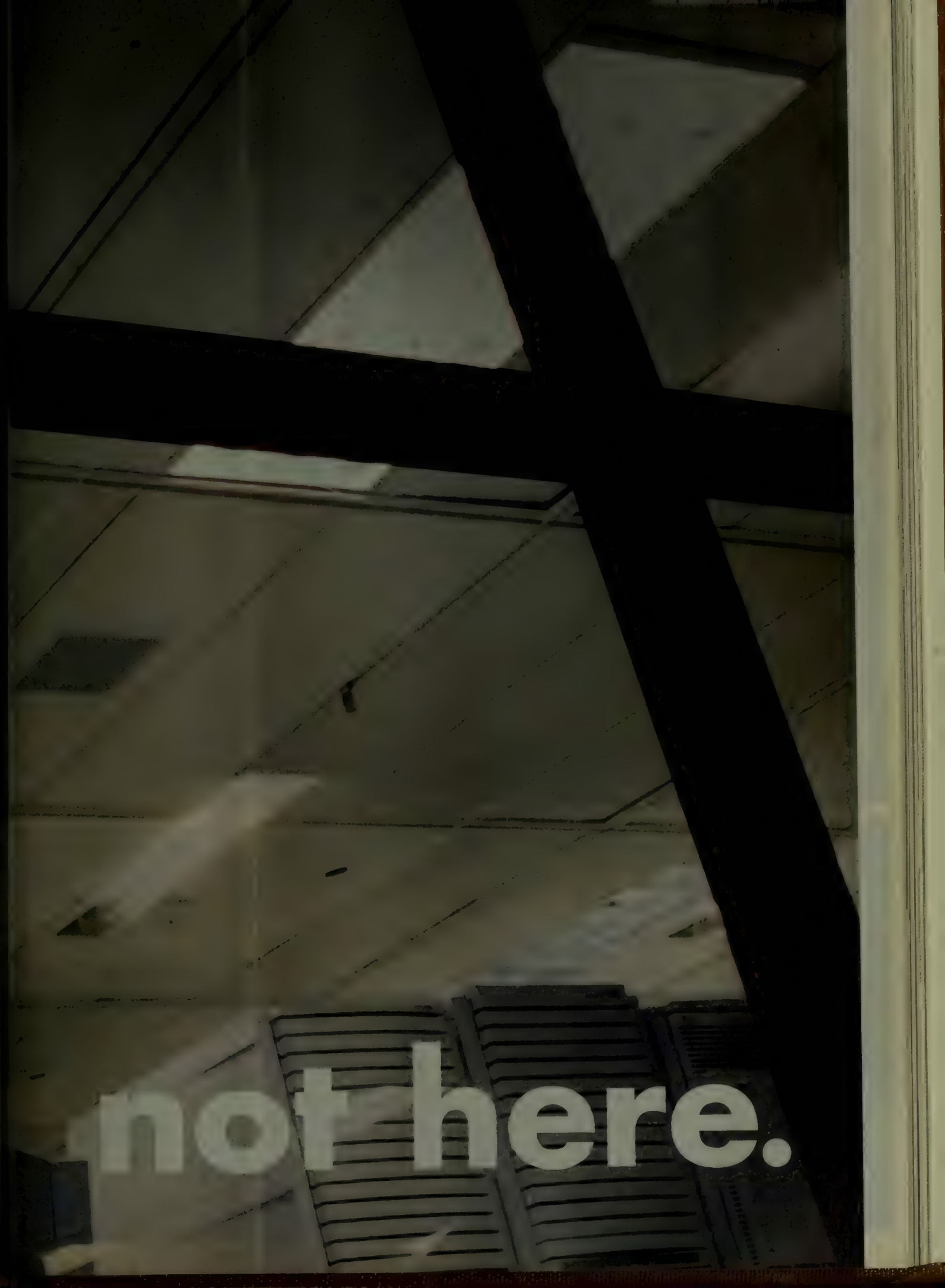
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THE BETRAYED INVESTOR

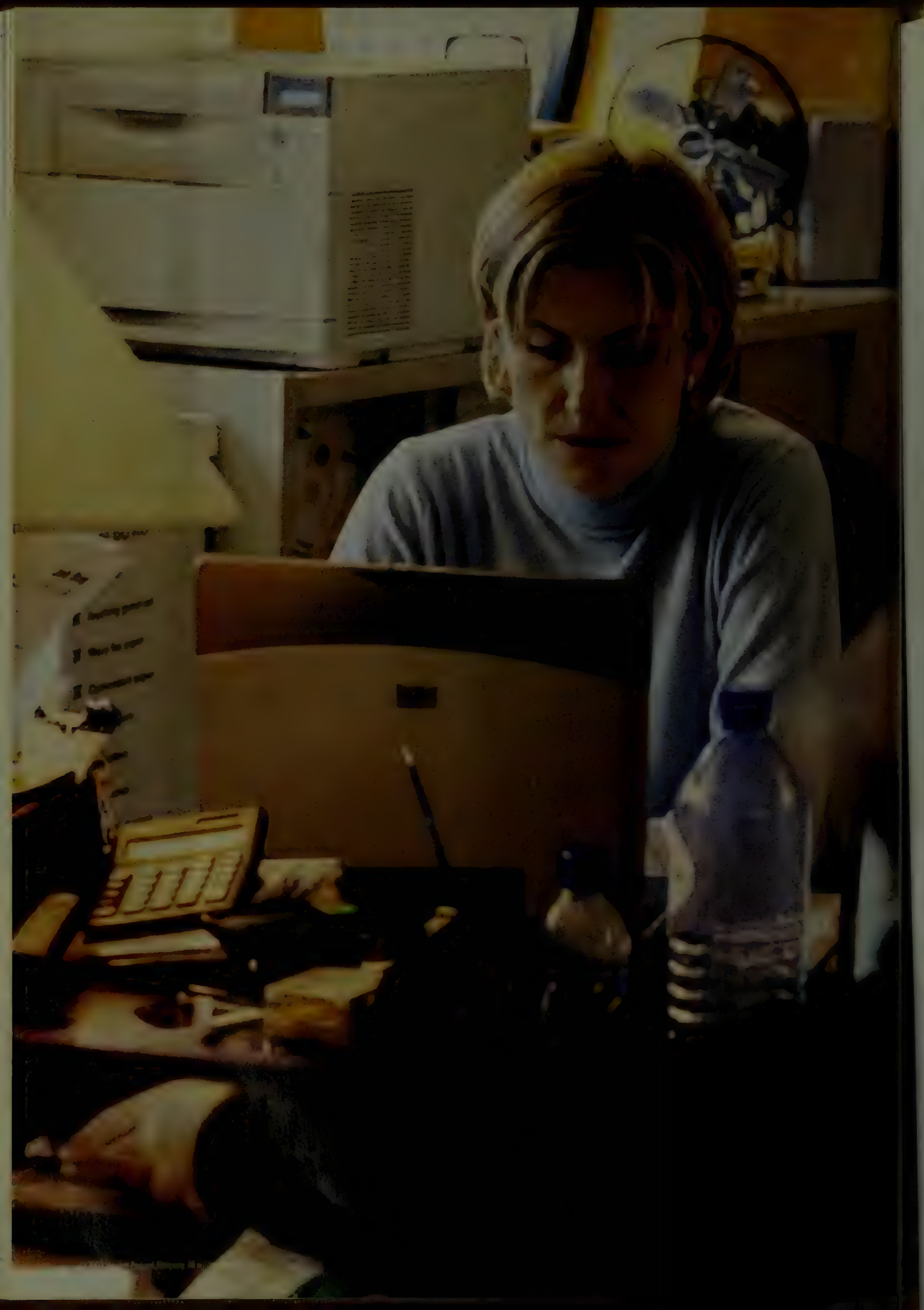
In the 1990s, a new class of investors became a powerful economic and political force. Now many feel misled by Wall Street, corporations, accountants, and the government. The strength of the recovery hinges on winning back their confidence. PAGE 104







not here.



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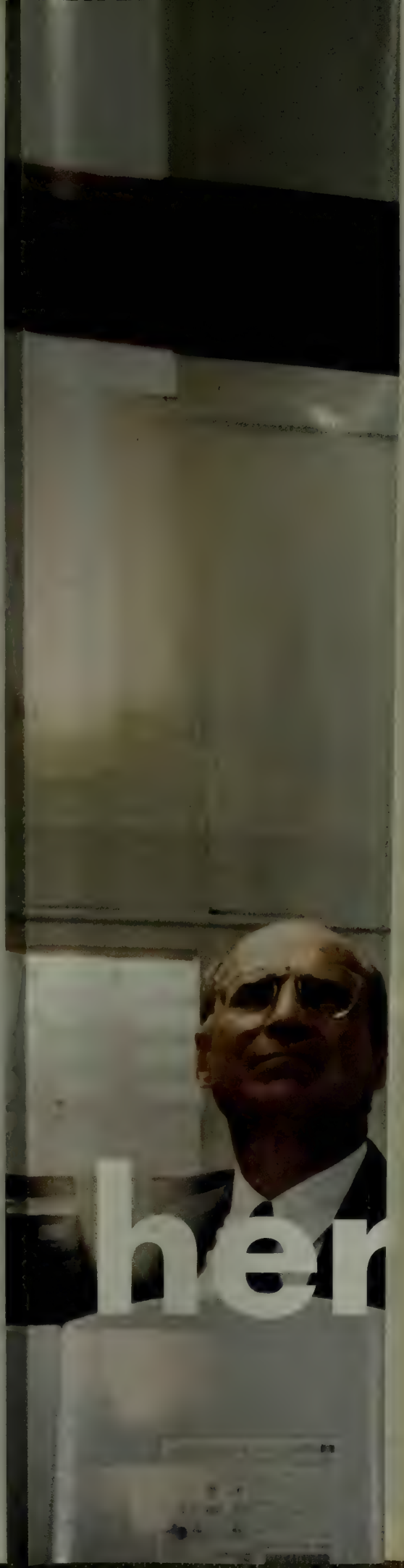
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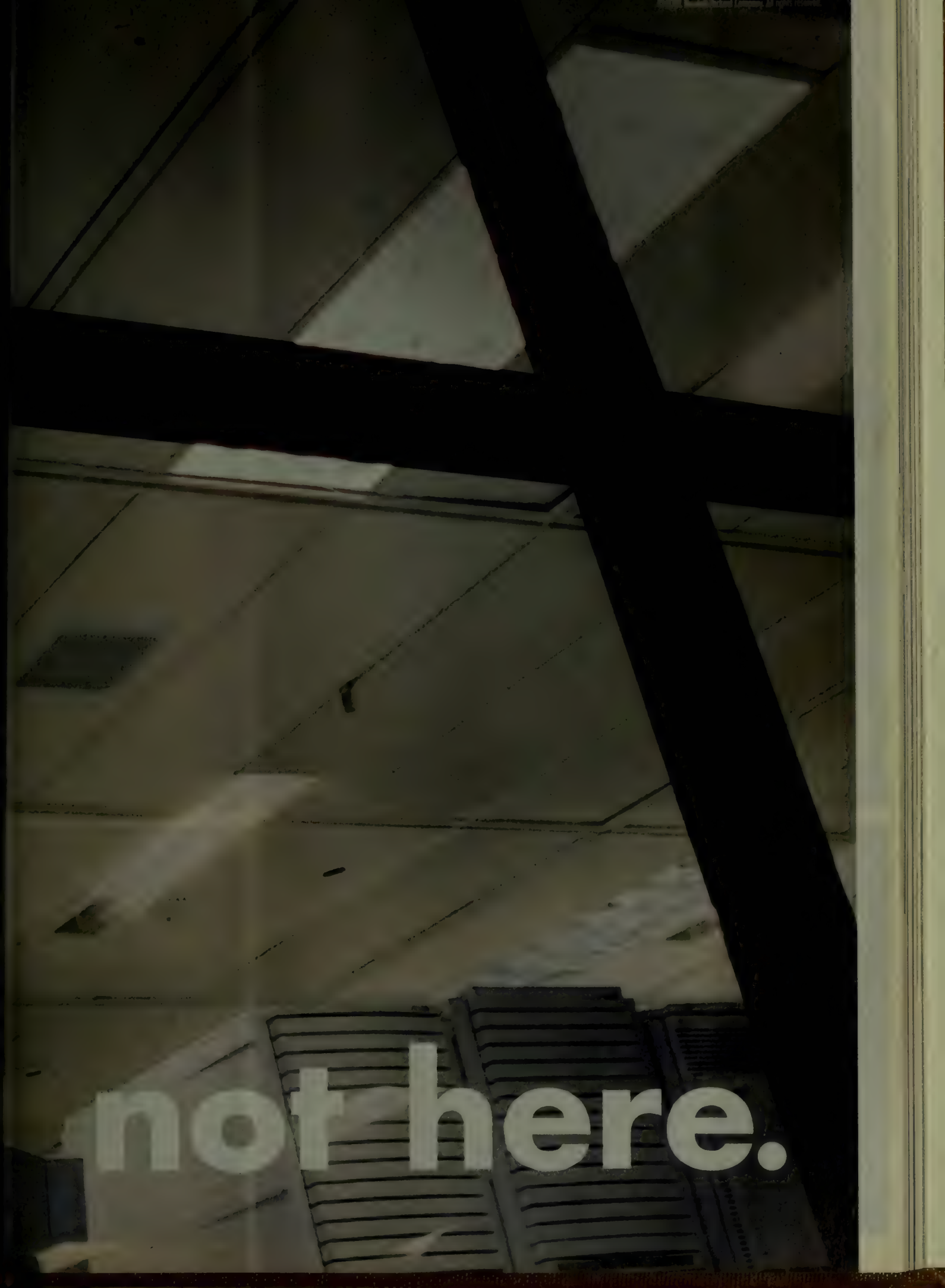
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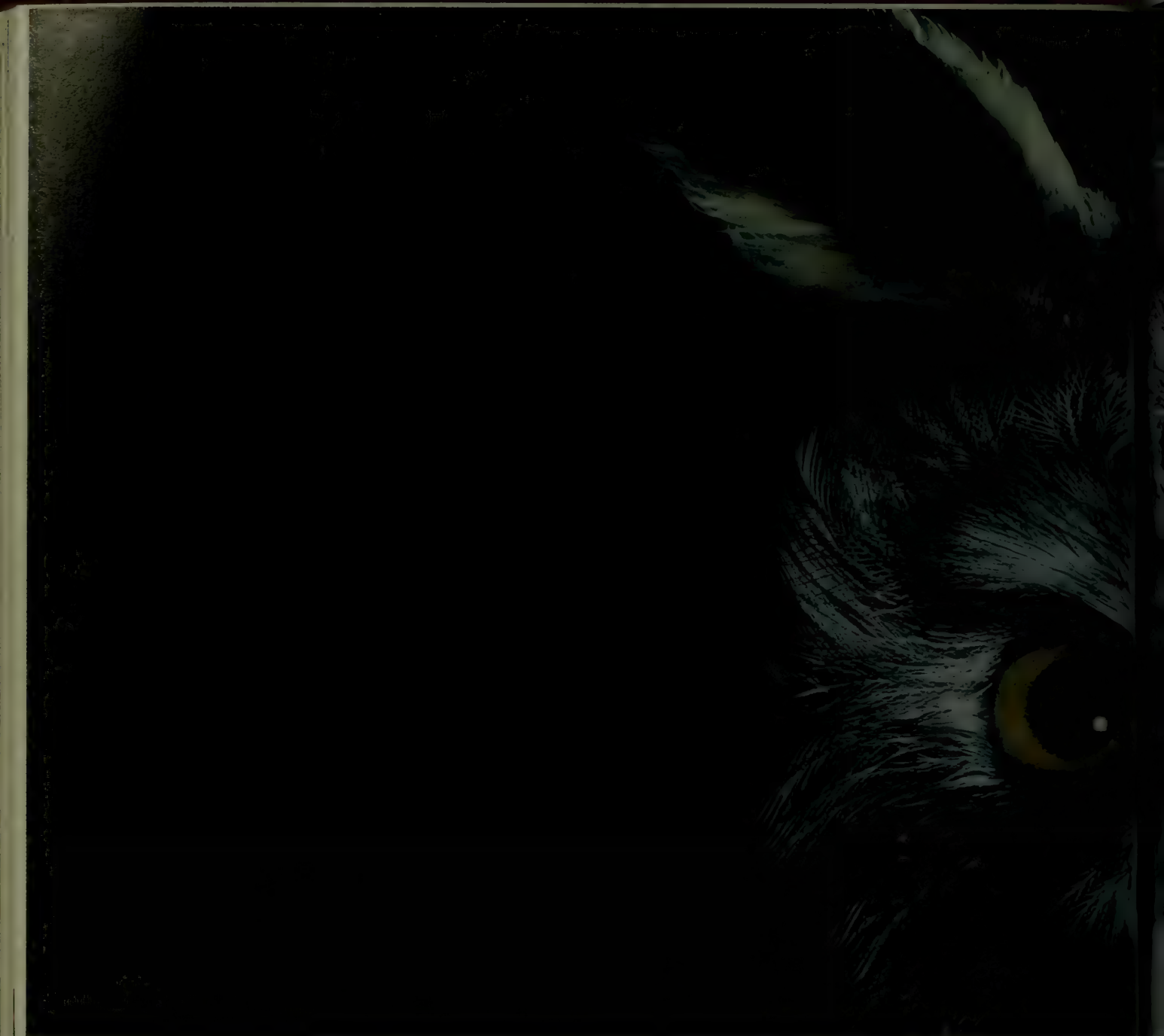
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BusinessWeek

FEBRUARY 25, 2002

Cover Story

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In the 1990s, a new class of investors—millions of working Americans pouring cash into stocks and mutual funds—became a powerful economic and political force. They bought into the idea that stocks could only make them richer. Then the market bubble burst—and then came Enron. Now many feel misled by Wall Street, corporations, accountants, and Washington. The strength of the recovery hinges on winning back investors' confidence

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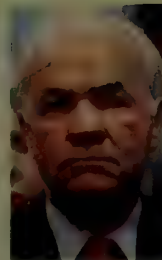
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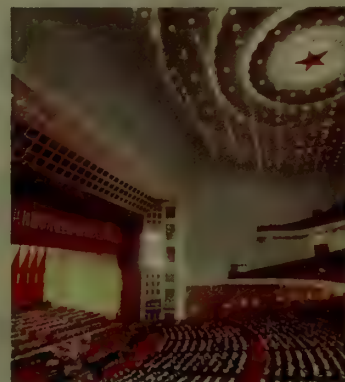
SHORT HOPS

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2001 was an ugly year for corporate
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CORPORATE SCOREBOARD

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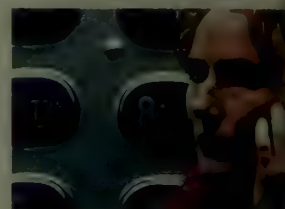
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Telecom Tidal Wave

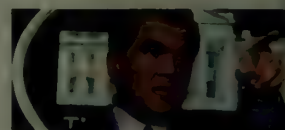
It started with Global Crossing's undersea-cable boondoggle and bankruptcy. Now, debt-burdened players large and small—in the U.S. and abroad—face a major shakeout



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Up Front

EDITED BY SHERIDAN PRASSO

ENRON REPORT

NOW, PwC IS IN HOT H2O

SO FAR IN THE ENRON SAGA, Arthur Andersen has borne the weight of accounting's failures. But that's about to change. A congressional source tells *BusinessWeek* that investigators have begun compiling documents to determine PricewaterhouseCoopers' role, too.

At issue is Pricewaterhouse's work for both Enron and those controversial debt-shielding partnerships controlled by then-Chief Financial Officer Andrew Fastow. On two occasions, the world's biggest accounting firm certified that Enron was getting a fair deal when it exchanged its own stock for options and notes issued by Fastow-controlled partnerships in 1999 and

2000. Investigators will ask whether those stock transfers really were "fair," as Pricewaterhouse certified. A Pricewaterhouse spokesman says the company stands by its earlier assessment of the deals and is cooperating with congressional investigators.

Investigators will also ask whether Pricewaterhouse had conflicts of interest: It did tax consulting for one of the partnerships, LJM2. Accounting experts say that could have affected Pricewaterhouse's advice to Enron. Pricewaterhouse says there's no conflict between tax consulting and preparing fairness opinions.

Pricewaterhouse's new CEO, Samuel DiPiazza Jr., is likely to escape the worst of the flak. Instead, ex-CEO James Schiro may well be the next one hauled before Congress. *Mike McNamee and Heather Timmons*



SCHIRO: Next to testify?

OLYMPIC LORE

SOLID GOLD FOR FASHION, EH?

BEFORE THE OLYMPICS, BERETS were largely limited to art-school nerds. But cute caps are all the rage since appearing on the heads of the U.S. team during opening ceremonies. Toronto-based Roots designed the U.S., British, and Canadian Olympic teams' uniforms. Its \$19.95 beret has become the must-have memento of the Salt Lake City Games. Fans line up to buy them. They're even getting bids of up to \$255 on eBay. Baseball caps, hats, fleece tops

and parkas are also selling well.

Roots is racing to keep up with demand and expects to sell at least half a million berets by the time things wrap up in Utah. "This is the most exciting thing to happen to us in 28 years," says Roots CEO Marshall Myles, who has 140 stores in Canada but just six in the U.S., plus two temporary ones in Utah.

Why is a foreign company making U.S. Olympic wear? Myles says the U.S. team approached Roots after U.S. athletes at the Nagano Games asked: "Why do the Canadians look so great?" International competition is what the Olympics is all about. *Diane Brady*



MICHELLE KWAN: Berets, berets

TALK SHOW "They won't call me that in Brooklyn."

—Honorary Knight and former New York City Mayor Rudolph Giuliani, after being asked if anyone would call him "Sir Rudolph"

DEAL MILL

SUDDENLY, FIORINA'S ODDS LOOK BETTER

IT'S LOOKING INCREASINGLY AS if Hewlett-Packard CEO Carly Fiorina could win her Mar. 19 proxy fight with dissident board member Walter Hewlett over HP's bid for Compaq Computer.

Many shareholders who share Walter's concerns have been selling shares, fearing the merger will go through. That dilutes his ability to nix it. Others are buying stock just in case HP manages to pull off the merger, cuts costs by \$2.5 billion, and ends up boosting the stock price.

Government filings show that big institutional investors Alliance Capital Management, Dodge & Cox, and Vanguard Investments increased HP holdings by 112%, 29%, and 6%, respectively, in the fourth



TEAMMATES? With Compaq CEO Michael Capellas

quarter of last year. At least one of HP's largest shareholders, which dumped millions of shares after the deal was announced, says it recently more than doubled its

Why are investors willing to bet on HP? Because HP and Compaq just announced better-than-expected quarterly results. And unless the merger ends up as a complete disaster, investors believe HP's stock is unlikely to fall further. *Peter Burrows*

THE LIST RIPPLE EFFECTS



Job losses caused by the events of September 11 continue to ripple. Here are the cities likely to see the largest percentage drops in employment due to the terrorist attacks:

METRO AREA	DROP IN 2002 EMPLOYMENT*	SEPTEMBER 11 CONNECTION
LAS VEGAS	5.0%	Tourism relies on air travel
MYRTLE BEACH, S.C.	3.6	Nation's highest concentration of restaurant employment
NEW YORK	3.4	Finance and advertising severely disrupted
RENO, NEV.	3.2	Heavy reliance on hotel/motel employment and air travel
ATLANTIC CITY	3.0	Nation's highest concentration of hotel/motel employment, but visitors come by car

*Est.

Data: Milken Institute

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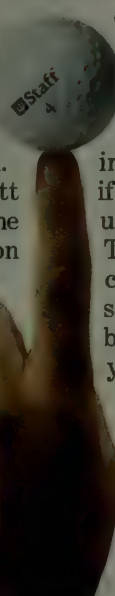
PRODUCT PEEK

SO YOUR LIE MAY ALWAYS BE TRUE

GOLFERS HAVE A LITANY of excuses for wayward putts—the wind, the club, not to mention the green. Some, including famed putt meister Dave Pelz, even blame the golf balls. Now, Wilson Sporting Goods agrees, saying that golf balls often don't roll straight. Naturally, Wilson has a solution—a new ball that rolls straighter. It goes on sale in March.

Small manufacturing irregu-

larities can cause the heavier core of golf balls to be off-center within the lighter cover, says Wilson's golf biz head Luke Reese. One in 12 high-end balls has the problem. To find out, float a ball in salt water and see if one side always comes up. Wilson says its new True ball, with a lighter core and heavier cover, solves the problem. "A bad ball can really hurt your putting," says Pelz. "If Wilson has eliminated the problem, this would be a plus." And if the ball still doesn't roll straight? Maybe it really is your fault. *Kimberly Weisul*



THE FEDS

IN THE TRADE WAR TRENCHES: WOMEN

YOU NEEDN'T LOOK UP statistics to know that men outnumber women in the top ranks of Washington. If you're interested, though, the ratio is 4 to 1: Of federal jobs paying \$120,000 or more, roughly 12,000 are held by men, 3,000 by women.

But there's one place where women have trumped the ratio: the Office of the

staff at most negotiating tables—are female, and two of the four deputy and associate trade reps are women. That's a ratio of nearly 1 to 1.

Hammering out trade deals can involve lots of travel and uncertain schedules, with long evenings and weekend work—hardly a family-friendly routine. And in some countries, women aren't exactly welcome as equals at the bargaining table.

But Catherine Novelli, an assistant rep who heads the Europe and Mediterranean desk, says women are attracted by the meritocracy and the lack of a glass ceiling at USTR. "Establishing your bona fides as a negotiator is always an issue regardless of your gender," says Novelli. "It is doubly difficult for a woman in the male-dominated cultures of some countries, but demonstrating your negotiating skills overcomes those barriers."

The trade office was headed by women, Carla Hills and Charlene Barshefsky, during the elder Bush and Clinton Presidencies. And even though the State Dept. once was too, its men-to-women ratio at the top level is 3 to 1. *Paul Magnusson*



WARRIOR: USTR's Novelli

U.S. Trade Representative (USTR). Even though the current top gun, Robert Zoellick, is a man, women hold many of the senior positions at the Cabinet-level agency that conducts America's trade talks with other nations and within the World Trade Organization. Eight of the 15 assistant trade reps—top

DRAWN & QUARTERED



PLANE TALK

IN EUROPE, NO FRILLS MEANS NO AIRBUS

AIRBUS CAN'T SEEM TO GET A ticket to the hottest party in its own neighborhood: the rapid expansion of no-frills air travel. None of Europe's discount carriers, from Ryanair to easyJet to Virgin Express, owns an Airbus. And on Jan. 24, Ryanair ordered up to 150 more Boeing 737-800s, making the Irish airline all-Boeing for at least 10 years.

Why can't Airbus get in on the action? Its slightly smaller A320 is cheaper—\$54 million, vs. \$60 million for a 737. But industry execs say Boeing probably did the Ryanair deal for \$40 million a pop. More im-

portant, the 737 has been in use since 1966, 22 longer than the A320. There's a supply of used aircraft for carriers starting up shoestring. "The 737 is the aircraft of choice for low-cost carriers," boasts Toby L. Hume, executive vice-president of sales at Boeing.

To sell to this crowd, Boeing would have to offer discounts, throw in



737: Working-class hero

such as spare parts and training. Worldwide aircraft orders are expected to grow 60% this year, but Airbus can't

ford such generosity. Airbus has fared better in the U.S. JetBlue and Frontier say Airbus is more fuel-efficient and has wider seats. In Europe, though, it's still in the party. *Carol M.*

THE BIG PICTURE

POWER DRAIN

Many electronic devices use power when they're in standby mode, even when turned off. Energy "leaked" in this way accounts for 5% to 10% of all residential electricity consumption in the U.S.

	AMOUNT OF ELECTRICITY LEAKED, YEARLY, BY KWH	ENOUGH TO POWER A 60-WATT BULB NONSTOP FOR
PERSONAL COMPUTER	14.9	10.3 DAYS
STEREO SYSTEM	26.3	18.3 DAYS
ANSWERING MACHINE	26.3	18.3 DAYS
TELEVISION	39.4	27.3 DAYS
VCR	51.7	35.9 DAYS
CABLE-TV BOX	94.6	65.7 DAYS

Data: Lawrence Berkeley National Laboratory

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**THE RIGHT WAY
TO SPOT A RECESSION**

"What recession?" (News: Analysis & Commentary, Feb. 11) raises questions about the National Bureau of Economic Research's approach to determining whether the economy is in recession. I am responding [as chairman] for the NBER's Business Cycle Dating Committee.

First, let me correct some important factual errors. Industrial production has been in decline since June, 2000, not October, 2000, as the article states. Further, you fail to mention that the decline in production has been far larger than the average of the previous six recessions, hardly consistent with your theme that this may not have been a recession at all. Second, you state incorrectly that "real incomes are still growing solidly." In fact, real income peaked in September. Again, the facts do not support your hypothesis.

Your article raises the important question of how to determine when the economy is in recession during periods of rapid productivity growth. A recession is a time when labor and capital are not employed as intensively as normal—unemployment rises, and capacity utilization falls. In the current recession, employment has fallen 1.1 percentage points below its peak in March of last year—a larger decline than the average of the previous six recessions. This fact, more than any other, has convinced the committee that there is no question that a recession has occurred.

With continuing substantial productivity growth, output and income have shrunk relatively little in this recession. Real gross domestic product, according to preliminary data for the fourth quarter of 2001, is about 0.3% below its peak in the second quarter. Real income is

also not far below its earlier peak in normal times—with normal growth of employment, rather than shrinking output would be growing robustly contracting. Again, there is no question that the economy is in recession.

We support your call for better data. But we depart vigorously from your claim that our view of the available data has failed to keep up with changing the economy. We stand by our determination that the economy reached peak in March, 2001, and contracted the months following that date.

Robert E. Hall
Stanford University
Stanford, CA

Editor's note: After peaking in March 2000, industrial production rose in April and August and September, and it "hasn't fallen since October," as we said. We did not ignore the drop in industrial production. We said that manufacturing was in its "worst slump since the 1930s," but as the NBER has revised, industrial production is a small declining share of output. Also, in the NBER's March, 2001, recession, real income has not declined in any month except October—following the September shock—and it has rebounded strongly. Our main point: High productivity growth places less importance on employment as a business cycle indicator, because output and real income can rise even if employment falls.

**HOW CAN THE GOVERNMENT
HEAD OFF ANOTHER ENRON?**

You say that bankers, analysts, accountants "have enormous conflicts of interest," which the 1933 Glass-Steagall Act aimed at overcoming. Its 1999 repeal "has ushered in their return" (Feb. 19, p. 10). You trust anybody anymore? (Feb. 19, p. 10). The way in which

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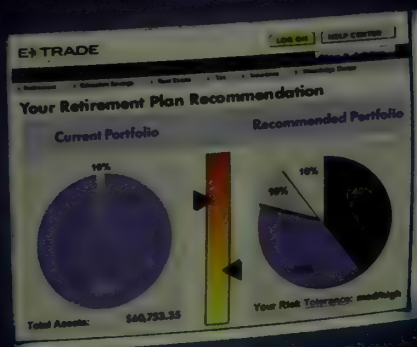
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of financial deregulation was rammed through during Clinton's second term was unfortunate, especially in these supervisory areas. I am worried about what may come as a result of the introduction of value-at-risk models, where the banking supervisors admit that they cannot track all the pieces of banks' portfolios, especially the off-balance-sheet derivatives—and supervisors ask the banks simply to provide what their strategies are for managing risk. This form of semi-self-regulation may hide a lot of vulnerabilities from supervisors, especially as barriers between financial services erode.

I have consistently been impressed with *BusinessWeek's* willingness to consider the positive role of government policy while keeping its (correct) fundamental belief in the need for active markets and entrepreneurial rewards.

Adam S. Posen
Senior Fellow

Institute for International Economics
Washington

It is tragic that Enron Corp. employees lost so much value in their 401(k) retirement plans ("Bracing for a backlash," Special Report, Feb. 4). However, to regulate how employees may allocate their contributions to their 401(k) plans would be yet another governmental invasion of privacy and curtailing of freedom in the name of saving people from themselves. If I wanted to put 100% of my 401(k) investment in my company's stock but regulators would not allow it, what happens if the company's stock doubles? Can I sue the government? Regulators are there to make sure corporations are not misrepresenting their financial situation, not to make investment decisions for people.

Jim Mason
Castle Rock, Colo.

"Can you trust anybody anymore?" (Cover Story, Jan. 28) carefully and accurately examines the failures and misconduct of Enron executives and board members. The problems are said to be systemic. Inexplicably, there is nary a mention of the enactment in 1995, over a Presidential veto, of the Private Securities Law Reform Act. The PSLRA established near-herculean obstacles to prosecuting securities fraud—including addressing the very kinds of behavior by Enron executives and their accountants from Andersen that were so universally criticized by the White House and Capitol Hill.

In the absence of any "smoking gun" information or any evidence of intent elsewhere unheard of in civil litigation, such cases were to be dismissed—without even allowing discovery to find out what documents remained after the shredder. In passing this thinly reasoned law, Congress opened the door; former Enron Chairman Kenneth L. Lay and his happy band simply walked right on through.

Those bipartisan "shocked and appalled" members of Congress now in search of who was responsible for Enron might start by looking in the cloak-room mirror.

Al Meyerhoff
Milberg, Weiss, Bershad,
Hynes & Lerach
Los Angeles

Editor's note: The writer's firm seeks to become lead counsel among the dozens of Enron cases filed, and is one of the top filers of shareholder suits in the U.S.

POLITICIANS, BEWARE OF FICKLE PUBLIC OPINION

In "Bush's new reality" (Cover Story, Feb. 4), it is interesting that you say "Bush [is] now basking in a Churchillian glow." I wonder if the President's advisers are aware that only two months after the defeat of Nazi Germany, Winston Churchill lost a bid for reelection primarily because of the public's concern over the postwar economy.

Some glow.

Lee Dribin
Los Angeles

Public accounting is like being in the CIA—when you do your job well, no one notices (or cares), but failures are always front-page news ("There's no positive spin on this one, Mr. Lindsey," Special Report Commentary, Jan. 28).

J.C. Boakes, CPA
Westampton, N.J.

"How to prevent future Enrons... And campaign finance shenanigans" (Editorials, Jan. 28) cites the \$5.8 million that Enron spent during

the past 12 years buying politicians—a measly \$483,000 per year. It is obvious that the \$80 billion company known as Enron, once the seventh-largest corporation in the world, was headed by a bunch of pikers! Are politicians unhappy because Enron didn't spend more?

John Stadler
Fox Island, Wash.

CORRECTIONS & CLARIFICATION

"The Fine Print" (BusinessWeek Invest Feb. 4) reported that IBM's pension fund boosted its 2000 earnings by \$824 million, or 7% of pretax income. This reflects the impact of IBM's U.S. pension fund alone. When IBM's non-U.S. plans are included, pension income boosted 2000 earnings \$1.171 billion, or 10.2% of pretax income.

PUTTING AN END TO THE NUMBERS GAME

In "Brutal honesty could force a market correction" (Special Report Commentary, Feb. 4), everyone is focused on the symptoms rather than the problem behind the pro-forma-numbers controversy. The answer lies in the operating results, debt load, and debt maturities. Notice the number of companies that get little notice when they take on off-balance-sheet activities, sizable debt at an early stage with earnings or assets to cover the maturities of the obligations. But, then again, we are too busy staring at the ineffectual net-income line. Who has time to look at the company's cash flow footnotes, and balance sheet?

Harvey N. G.
President &
Sunrise Capital Co.
Snohomish, Wa.

Your Enron Watch series fails to cover with an important aspect of this debate. Until the last moment, both Standard & Poor's Corp. and Moody's Investors Services were giving it investment-grade ratings. Many investors, including pension funds, were misled. It seems to me that the filter used to devise ratings must change: The real challenge is to come up with new rules (probably mathematical in nature) that could reasonably evaluate risk in the present environment. The Long-Term Capital Management affair should have concentrated everybody's mind a long time ago.

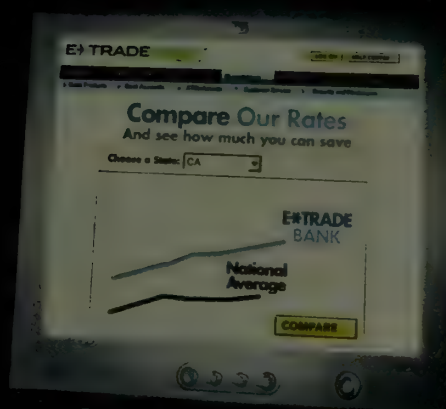
Max Papadopoulos
Monterey, Calif.

I read the twisted tale of former Enron Chief Financial Officer Andrew Fastow's financing scandals and bumptious behavior with utter disdain ("The numbers behind the deal machine," Special Report, Feb. 4). While there's much to be said about self-confidence and driving a hard bargain, at the end of the day, adhering to professional decorum and acting responsibly keeps the playing field



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Readers Report

level. Looking back, I'm surprised the Enron empire did not fall sooner.

Hunter Lynne
San Diego

A BLACK EYE FOR ACCOUNTANTS THAT WON'T GO AWAY SOON

"Accounting in crisis" (Cover Story, Jan. 28) says: "There is... no substitute for personal integrity." CPAs are required to study professional ethics only at the beginning of their careers. To be successful in the profession, one learns quickly to cater to the requests of the clients who pay the highest fees, regardless of ethical considerations. Or, one seeks other employment.

John Mitchell, CPA
Sparks, Nev.

There is another solution to this problem not mentioned in your articles: Vote "no" when your next proxy is solicited if Arthur Andersen is proposed as the outside auditing firm. If we all do this, the message will be loud and clear to all accounting firms.

Donald G. Manly
Salem, S.C.

I suggest the following "attest" paragraph for Big Five audits: "None of us at this firm has the slightest idea what or how this company is doing. We will attest, however, that the pictures of the president and chairman of the board did represent what they looked like at the time—although we have no idea what they look like now."

Len Gold, CPA
East Windsor, N.J.

Bruce Nussbaum's pronouncement, "In short, most certified public accountants feel little duty to the public at large," is uninformed and unfair ("Can you trust anybody anymore?" Special Report, Jan. 28). To infer from Andersen's failings that most CPAs must likewise have little regard for the public interest would suggest a similar inference that some uninformed journalists define the level of honesty and accuracy we can expect from the entire media.

Melody L. Pound, CPA
Oakland, Calif.

A CURE FOR U.S. HEALTH CARE

Not-for-profit community provider networks such as California's Sutter Health play a critical role. Despite the impression given in "The new power play in health care" (Social Issues, Jan. 28), com-

munity hospitals are being forced to down or eliminate services at an alarming rate. By pooling resources, provider organizations of our network have or replaced more than a dozen hospitals and care centers in recent years. We've also reduced overhead, savings through joint purchasing, and improved quality.

The emergence of provider networks pales in comparison to the earlier, aggressive, nationwide health maintenance organization consolidations. 20 separate plans we negotiated in 1990 have consolidated into just super-HMOs. Their leverage and power over providers has never been so strong or threatening.

Most California hospitals and doctor groups lose money. Among health care power players, providers are outgunned, overmatched, and underfunded.

Cyndi Kettner
Sutter Health
Sacramento

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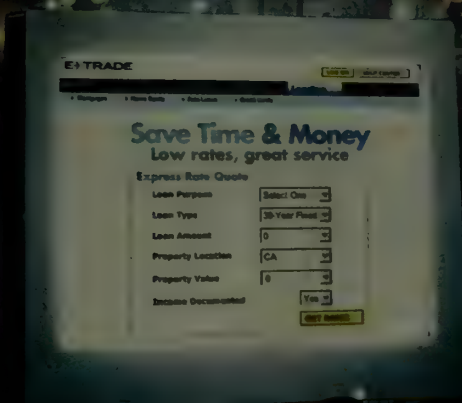
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DOT.COM

The Greatest Story Ever Sold

By John Cassidy

HarperCollins • 372pp • \$25.95

HOW THE TECH BOOM WENT BUST

When I started John Cassidy's new book, *dot.com*, I was startled by the amount of material pulled from other sources. After reading one good anecdote about futurist George Gilder, I noticed a nearby footnote, flipped to the back, and found that the story came from a *Forbes* article. A wry Netscape tale led me again to the back pages, where I found it was from a book on Netscape published several years ago. And good personal detail on AOL Time Warner Chairman Stephen M. Case? From none other than *BusinessWeek*. Clip job, I thought!

But soldier on, dear readers. Cassidy, a staff writer at *The New Yorker*, does have much to offer in this chronicle of the Internet's financial rise and fall. Although sections on individual companies lean heavily on other writers' work, there's plenty of Cassidy's own reporting, analysis, and insight throughout. He really hits his stride when he focuses on the economy, the Federal Reserve, and the psychology of manias.

No question, Cassidy has a rich and fascinating story to tell. As he explains, the '90s stock boom was about more than day traders and computer-science graduates trying to get rich. It also was about "a lone superpower that believed it had discovered the secret of eternal prosperity. It was about a group of pundits promoting the next 'big thing.' It was about Wall Street bankers eager to cash in on an unprecedented source of revenues." Above all, he says it was about "ordinary Americans, enticed by the prospect of instant wealth, parting with their hard-earned currency for worthless pieces of paper. In short, the Internet boom and bust was about America—how it works and what it thought of itself in that short interregnum between the end of the Cold War and September 2001."

dot.com excels at providing insight

into events that, in retrospect, seem inexplicable. Why, for example, did professional money managers pour funds into the stocks of Internet companies that had no profits and no prospects? Maybe some of the money managers were dim, but many, perhaps most, knew that dot-com stocks were wildly overvalued. The answer, Cassidy suggests, is that such pros have little choice but to follow the herd. They're judged on how well they perform against benchmarks, such as the Standard & Poor's 500-stock index. Stick close to the index, and your job is safe. Make a contrarian bet that turns out to be wrong, and you're toast.

One telling example is the story of Jeffrey Vinik, manager of Fidelity's Magellan Fund, the biggest mutual fund in the country. In early 1996, after a big bet on technology paid off, Vinik grew concerned about high valuations. He then moved some of Magellan's money into bonds. His performance suffered, compared with that of his peers, and, by May, he had left Fidelity to run his own money-management firm. Although Vinik said he had not been fired, Cassidy notes that other fund managers drew a lesson from Vinik's experience: "taking money out of the stock market could be a career-ending mistake."

Cassidy also does an excellent job of sketching a nuanced picture of investment banks. For example, Morgan Stanley Dean Witter & Co. has been vilified for analyst Mary Meeker's indiscriminate hyping of Net stocks. Cassidy points out, however, that investment banks are hardly monolithic. At Morgan Stanley, Barton Biggs, chief global investment strategist, and Byron Wien,

ex-chief investment strategist, were relentlessly bearish in the late '90s. Investors could have read a "doom" essay from Biggs" in Morgan Stanley newsletters, right alongside Meeker's breathless "buy" recommendation.

What's bound to be controversial is the blame Cassidy lays at the door of Fed chief Alan Greenspan. The book suggests that Greenspan made two mistakes: not raising interest rates enough to prick the stock market bubble in 1998 or 1999, and not lowering rates soon enough after the market crash in early 2000. In August and September 1998, the market wobbled under twin pressures of the Long-Term Capital Management debacle and Russian default on some of its debt. In response, Cassidy writes, Greenspan cut interest rates on Sept. 29 and then again on Oct. 15. "His actions added to the general belief that the Fed would always

be there to bail out investors if anything went wrong. This made investors more willing to take risks, further inflating the Internet bubble, says Cassidy.

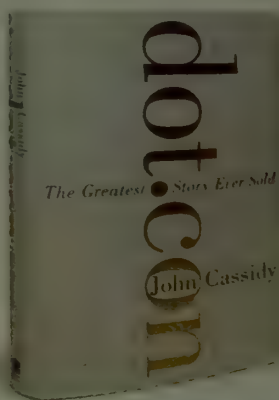
Then in May, 2000, the Nasdaq fell 30% from its March peak, the Fed raised rates for the third time in two years. "Greenspan and his colleagues seemed to be failing the disastrous precedent of 1929, when their predecessors

maintained a tight policy following the stock market's collapse. Greenspan was well aware of the Fed's error in lowering the Great Crash, but on this occasion he didn't think there was danger of an economic slump." More than a year later, recession had set in.

Pointing the finger at Greenspan seems too simplistic. There are, after all, lots of other villains to choose from, and some—notably investment banks and venture capitalists—made big money from selling stock in now-worthless companies to the public. But this is the real value of Cassidy's book. In the end, the book's questions on the economy and the Fed brings his own expertise to bear, offering up fascinating, if controversial, interpretations. Agree or disagree, you haven't read it from anyone else.

BY PETER ELSTROM

Elstrom writes about technology and telecom.



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BOOK BRIEFS

YELLOW

Race in America Beyond Black and White

By Frank H. Wu

Basic Books • 397pp • \$26

RACE MATTERS

Frank Wu, the Chinese-American author of *Yellow: Race in America Beyond Black and White*, teaches law at Howard University in Washington, D.C., a historically black institution. In social encounters, writes Wu, "on more than one occasion, a person has looked me over carefully, paused, and then stammered, are you actually black?" (He's not.) Wu is asked so often why he teaches at Howard that he's tempted to respond with a printed handout. But the incidents illustrate a lesson: Although few Americans believe they are racists, race underlies our daily perceptions. We're "racial without being racist," writes Wu. Few would likely think twice if Wu taught at a predominantly white school, because an upwardly mobile Asian American is expected to want to be in the mainstream.

Wu joins a growing group of Asian-

American essayists, including former Clinton White House speechwriter Eric Liu and journalist/activist Helen Zia, who are building a body of literature reflecting on Asian Americans' place in the U.S. All bring the tools of their own trades. Wu's book lacks the poetry of Liu's writing or Zia's compelling narratives. But with a clear expository style, the law professor excels at using logic to unclutter the inconspicuous manifestations of racial thinking.

It starts with everyday comments encountered by Asian Americans, such as "Where are you really from?" Seemingly innocuous, the question reflects the persistent view of Asian Americans as foreigners. "Discrimination based on race is immoral, but discrimination based on citizenship is not," writes Wu. So, by turning Asian Americans into noncitizens, even those who don't think of themselves as racists feel free to "turn us into a racial threat," says Wu.

One doesn't have to go back far for examples. Just three years ago, Chinese American Wen Ho Lee, a scientist at Los Alamos National Laboratory, was prosecuted for selling nuclear secrets to China, but in the end the feds

dropped almost all of their 59 counts and Lee pleaded guilty to one misdemeanor. Wu views the event as a study in racial profiling. Six years after the firestorm over Democratic campaign gifts from Asian national leaders, covered barely disguised racist currents. At the time, Ross Perot, of Democratic fund-raiser Huang, an American: Huang is still out there he work for the Democrats. V n't you like to have someone there named O'Reilly? know, so far we haven't an American name."

In addition to exploring and other examples, Wu

about the complex politics between black, white, and yellow. He considers affirmative action and examines the active side of the seemingly benign of Asian Americans as a model minority. He gets beyond the black-white dichotomy that we're used to and takes us into the 21st century on the race question. Overt bigotry may be less of a problem today, but a racial subtext—some benign, sometimes ugly—still lurks all of us. It's better to recognize that we are to improve race relations.

BY CATHERINE

THE RULE OF THREE

Surviving and Thriving in Competitive Markets

By Jagdish Sheth and Rajendra Sisodia

Free Press • 277pp • \$28

FOUR'S A CROWD

How come Microsoft, which has a spotty record at best when it comes to innovation, became a leader in nearly every category of software application? Why was mega-retailer Wal-Mart able to crush its once-bigger competitors? Why was Lowe's tactic of cloning its bigger rival, Home Depot, so successful? And in an economy dominated by giants, why do some small fry such as Victoria's Secret and Southwest Airlines thrive?

Responses to these and many more questions may be found in the provocative if much overstated *The Rule of Three: Surviving and Thriving in Competitive Markets* by Jagdish N. Sheth, professor of marketing at Emory University's Goizueta Business School, and Rajendra S. Sisodia, marketing professor at Bentley College. The authors argue that in mature markets, competitive forces dictate an

optimum of three big players that together control 70% to 90% of sales. Companies pursuing strategies appropriate to their market position—No. 1, 2, or 3, or a narrow niche—will survive and flourish, they say. They also attempt to explain consolidation and to show why many seemingly strong companies, such as Kmart Corp., stumble. Grand theories such as this are enticing. But they also immediately prompt the reader to think of cases where the theory doesn't work—and in this instance, there are many.

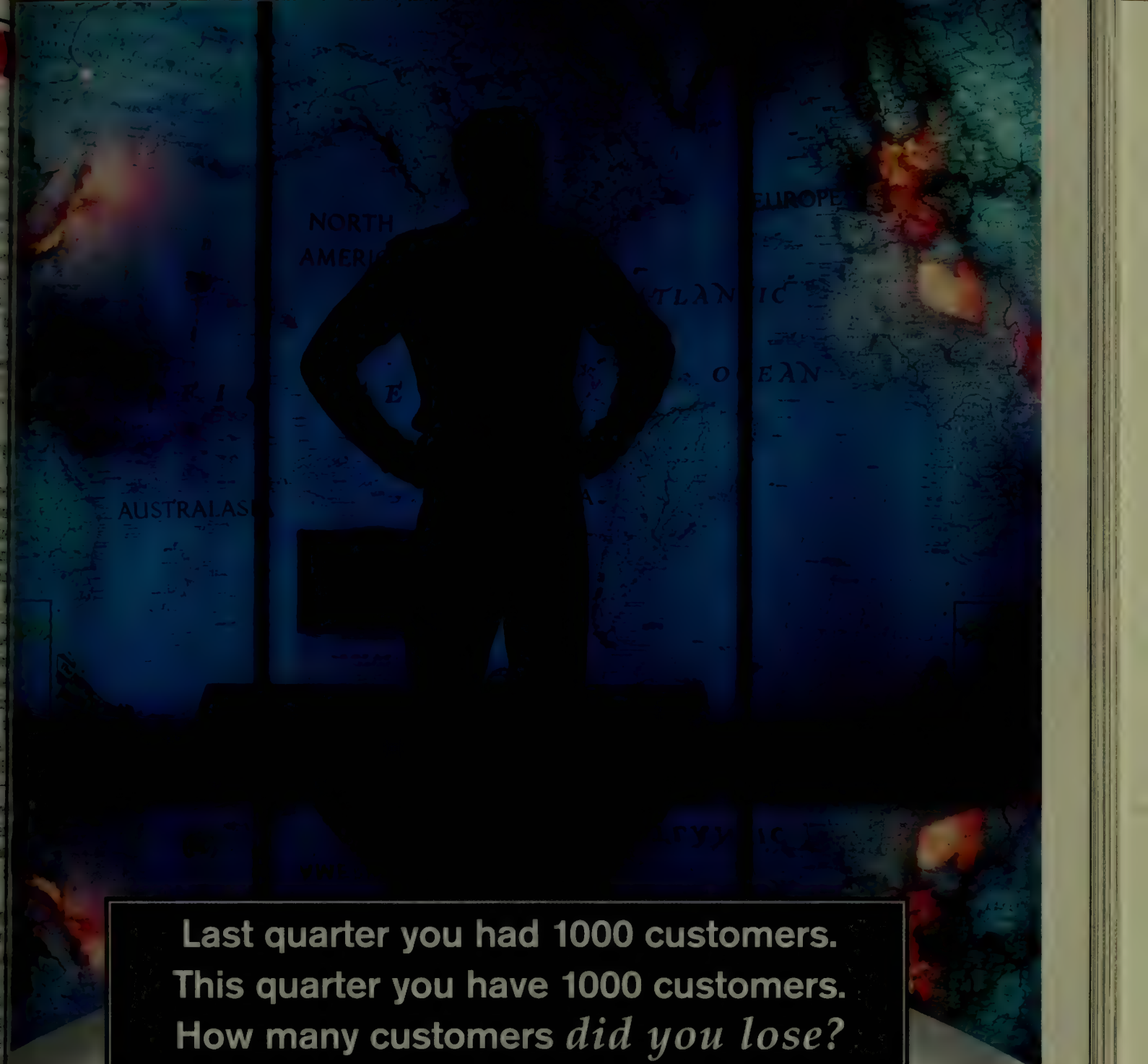
Here's some of what the authors argue. Microsoft Corp., as the market leader, does not have to innovate to be on top: With its economies of scale and speed, it can just be a rapid follower of innovators. In contrast, Wal-Mart Stores, once the No. 3 retailer (only Kmart and Sears Roebuck were larger) had to innovate. And it did, with low prices, inventory tracking, and entry into small-town markets that Kmart had ignored. A No. 2 company such as Lowe's, meanwhile, can thrive just by cloning the industry leader's big-box layout in a smart way, offering appliances as well as hardware. All of these companies are what the authors call generalists, in contrast to

specialists such as Victoria's Secret and Southwest, which have created their niche markets. Such outfits operate under a different set of rules, say Sheth and Sisodia.

The authors' discussions of corporate strategy are more persuasive than their description of consolidation. In most industries, they say, there are three dominant players: American, United, Delta; McDonald's, Burger King, Wendy's; NBC, ABC, and CBS. These are like oligopolies, with little likelihood of either collusion or destroying each other. Because of inherent market efficiency, though, any fourth player is endangered.

Here, one sees the authors force evidence into the straitjacket of their theory: Are Northwest and Continental Airlines really slated for extinction? And what about Fox TV, which is gobbling up market share? Other industries, such as bricks-and-mortar book retailing, are dominated by two companies but the authors include a weak third player to fill out their quota. Sheth and Sisodia try to keep the descriptive consolidation dynamic—saying that their change will come in autos and housing, for example. In the end, *The Rule of Three* founders under the weight of many exceptions.

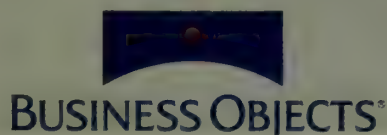
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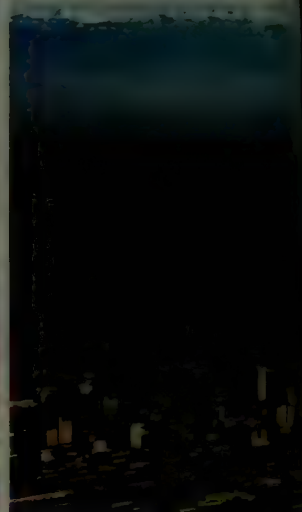


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ASTHMA TEST

As air pollution rises, the San Joaquin Valley asthma in Fresno (below) is soaring



EDITED BY HARRY MAURER

A LUSH VALLEY STRUGGLES TO BREATHE

He's only midway through a four-hour shift, but Dr. David Pepper is already consulting with his third asthma patient of the day, a former field worker whose chronic breathing difficulties prevent her from doing housework or playing with her three children. "On a typical day during the summer months, when the air quality outside tends to be at its worst, we'll see 40 to 50 asthma patients," says Pepper, a wiry, 42-year-old respiratory specialist who oversees a team of residents at his hospital. "Numbers like this were once unheard-of around here."

Los Angeles? Nope. Houston, maybe? Guess again. This is Fresno, Calif., hub of the San Joaquin Valley, one of the richest agricultural areas in the nation—and now, one of the smoggiest. On many days, the air in this sprawling city of 430,000 hangs so thick that it's impossible to see the picturesque Sierra Nevada Mountains just 20 miles east of town. Concentrations of ground-level ozone (better known as smog) and airborne particles such as soot and dust regularly exceed federal

health standards. Last October, the Environmental Protection Agency (EPA) classified the San Joaquin Valley as a "severe" ozone region, a ranking shared by a few major metropolitan areas. Earlier last year, the American Lung Assn. reported that three of the four smoggiest cities in the country—Bakersfield, Fresno, and Visalia-Tulare-Porterville—were in the same valley. And now, the worsening pollution has

set off a fierce debate about how to fix it.

Why should a valley mostly known for a cornucopia of vegetables and fruit be struggling to breathe? Partly it's a matter of geography: The 270-mile valley is shaped like a bowl, and surrounding mountains trap pollutants that drift southward from cities around San Francisco Bay. But mostly it's an old environmental villain: cars and trucks. Boosted by rapid growth—during the 1990s, the valley's population jumped 18%, to 3.3 million—"the amount of vehicular traffic on our roads and highways has grown significantly," complains David L. Crow, executive director of the San Joaquin Valley Unified Air Pollution Control District. Crow figures "mobile sources" account for some 60% of the smog in the valley.

Besides cars, other sources of pollution include emissions from agribusiness equipment and the oil-and-gas extraction operations that dot the valley's southern end. As a result of all this gunk pouring into the air, the San Joaquin Valley Basin exceeded the federal 8-hour ozone standard 103 times in 2000 and 101 times in 2001, the first years in which the valley recorded more violations than the Los Angeles area's South Coast Air Basin.

As pollution has worsened, the capita incidence of asthma in the valley has risen to nearly twice the 5% national average, and Fresno now has the country's third-highest rate of asthma-related mortality. Only New York City and Chicago top it, according to the American Lung Association's Community Asthma Education & M





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Letter From California

agement, a program run by Community Medical Centers of Fresno. "To some extent, the increases we're seeing reflect better diagnosis and population growth. But it's clear that respiratory diseases are rising faster here than in most parts of the country," says Kevin Hamilton, the program's coordinator.

Adds asthma specialist Pepper, who works at Fresno's University Medical Center: "What's most alarming to me is the toll this illness is taking on our children." Reported asthma cases among students attending Fresno's public schools surged 156% between 1990 and 1999, far exceeding an 18% growth in student enrollment, according to Fresno Unified School District statistics.

The smog also exacts an increasing cost from the valley's mainstay, agricul-

etables, and nuts, and whose agriculture annually pumps about \$14.5 billion into California's economy.

Given these worries, activists say that government isn't being aggressive enough in cleaning up the air. "One of the main reasons our air remains so polluted is that the EPA and other agencies have neglected the valley," says Kevin Hall, an outspoken member of Fresno's Sierra Club chapter. The Sierra Club belongs to a coalition of medical, environmental, and community groups that filed a lawsuit last November against the EPA for, among other things, failing to act on a plan, submitted by the San Joaquin Valley air district in 1997, to reduce dust, soot, and other tiny airborne pollutants. The suit was settled on Jan. 15, giving the EPA until

can only do so much," says Crow. "We're fighting a battle of attrition against air pollution until the valley comes up with better land use and transportation planning, and finds a way to reduce vehicle-miles people are traveling."

Regulatory efforts have also been hampered by local industries, claim environmentalists. "Agencies like the air district and the California Air Resources Board have repeatedly bowed to pressure from agribusiness, oil companies, and developers," says Bruce Nilles, a lawyer at Earthjustice, a San Francisco law firm that handled the lawsuit against the EPA.

As an example, Nilles points to the air district's approval last November of a dust-control plan that exempts

equipment traveling on unpaved roads. Farmers insist the exemption is justified: "We got involved in the [dust-control] plan because of development because we were concerned about the accuracy of the data. The air district was using data," says Manuel Cunha, president of the Nisei Farmer League, a Fresno long-standing group. Early drafts of the plan "were full of factual errors that could have ended up costing farmers millions."

The question is whether savings by industry will end up costing more in health problems. Pepper frets over the millions of new residents who will

ther move to or be born in the valley in coming years. "Population growth is inevitable because homes are so much more affordable here than in the coastal metro areas, and because birth rates are high in the valley. But if things don't change as they are, we're going to have the worst air in the country," says the doctor, sipping a beer after work at a bustling café in Fresno's artsy Tower District. Indeed, the San Joaquin Valley is projected to remain one of California's fastest-growing regions: Its population will more than double, to 7.3 million, over the next 40 years, according to estimates by the state's Finance Dept. Muses Pepper: "I often wonder if these new arrivals know what they're getting into."

JOHN DODD

Doxey lives in San Francisco and often writes about environmental health issues.

MURKY AT NOON

The Sierra Nevada mountains, just 20 miles from Fresno, often can't even be glimpsed



ture—ironically, since farm equipment spews out a goodly share of pollutants. Ozone interferes with photosynthesis and other plant functions, limiting plants' ability to grow and reproduce. Studies show that ozone concentrations commonly found in the San Joaquin Valley can cut harvest of some crops by 25%. The air district estimates conservatively that crop damage resulting from smog costs valley farmers more than \$150 million per year. "And we may only be seeing the tip of the iceberg. We still don't know, for example, what the long-term effects of ozone exposure will be for soil or orchard trees," says David A. Grantz, director of the University of California's Kearney Agricultural Center, about 15 miles south of Fresno. Grantz worries that worsening air pollution could have "serious long-term ramifications" for the valley, which produces about a third of America's fruits, veg-

August to either approve or reject the plan submitted by the district.

For its part, the EPA is quick to admit that it has focused more on cities such as Los Angeles and Phoenix, which have managed steady air-quality improvements in recent years. "We haven't paid as much attention to the San Joaquin Valley as we should have," acknowledges Jack Broadbent, the EPA's director of air programs for the region that includes California. But that's changing, he says, pointing to the EPA's recent classification of the valley as a "severe" ozone region, a move that compels the air district to produce a plan for reducing smog-forming emissions by 30% over the next five years.

The air district itself argues that it's too dependent on other agencies to mount a campaign on its own. "We haven't made as much progress as we would have liked, but [the air district]



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CAMP OUT MUTTY SPAMMERS



My e-mail is getting uglier every day. The regular flood of get-rich-quick schemes and phony Viagra offers has been joined by a stream of increasingly explicit solicitations for pornographic Web sites, sometimes accompanied by sample pictures.

I'm no prude, and I don't much care what consenting adults choose to do. But I don't want this thrown in my face. It is time for the Internet community to take concerted action against junk e-mail in general and porn spam in particular. Unfortunately, the parties in a position to act, Internet service providers and the big network operators, all seem to believe this is someone else's problem.

There is little that individual mail recipients can do because the spammers are smarter than the filters designed to block them. A few months ago, the junk-mail filters at Hotmail caught more than three-quarters of the spam; today, it is less than half. If you rely on the do-it-yourself filtering in programs such as Microsoft Outlook or Outlook Express, the task is hopeless.

I have spent many dispiriting hours tracking the sources of porn-spam e-mail and the Web sites the messages promote. The returns on these messages, often popular free mail services such as Yahoo or Hotmail, are invariably fake, so it takes some detective work. This much has become clear: The distribution of spam, including porn, relies on facilities provided by major carriers and ISPs that either provide Internet connections or host the Web sites of spammers.

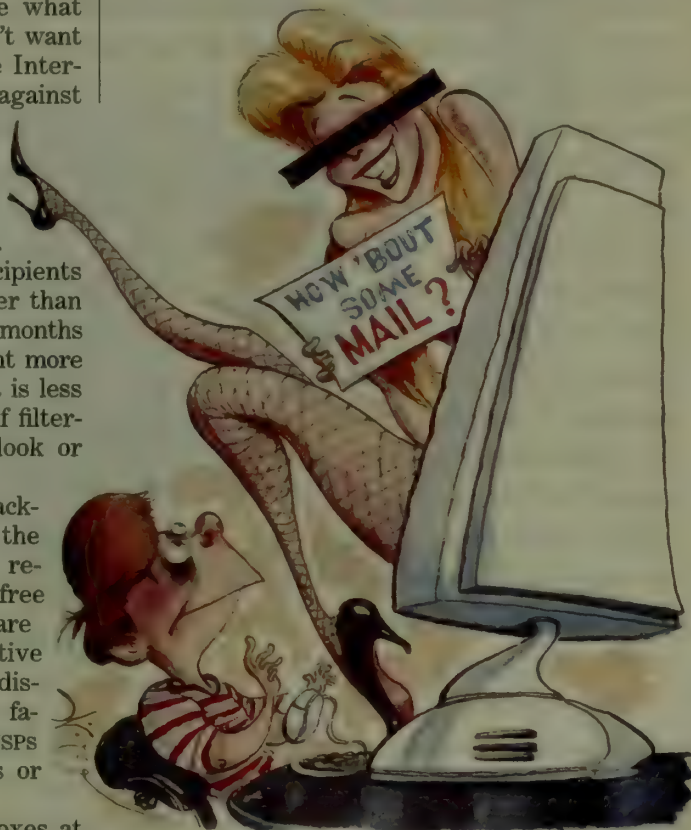
Complaints to abuse-prevention mailboxes at the UUnet unit of WorldCom, NTT Verio, and EarthLink produced only automatically generated form responses. Asked about mail offering "live Indian sex shows" that appears to have originated within the UUnet system, a WorldCom spokesperson declined specific comment, saying only, "Our acceptable use policy speaks for itself." That policy states that "the sending of unsolicited messages...is strictly prohibited." Surely the industry can take more responsibility than this. The only substantive response I received to a complaint came from Rogers Cable in Canada, which reported that "we have taken appropriate action with this subscriber."

Network operators should enforce their own terms of service, which always prohibit spam and usually bar operation of adult sites. But there is more dramatic, and probably more effective, action that service providers and

other mail system operators should take.

Spammers either use tolerant ISPs or hide their tracks by bouncing messages off other people's mail servers. Such "open relays" are relics of the days when the Internet was a small, trusting community. Now the relays are an invitation to abuse. Responsible mail system operators—ISPs, corporations, and institutions—should refuse to accept mail from any network that allows spammers to operate or that hosts open relays. And they should support the volunteers at organizations like Open Relays Black-hole Zone (orbz.org) and the Spamhaus Project (spamhaus.org) who struggle to detect and list rogue operations.

Blacklisting whole networks is rough justice, since the legitimate customers of ISPs that abet spam will have theirs rejected along with the of-



fenders. But those honest customers will force the ISPs to dump the miscreants and make honest but clueless customers configure their mail servers properly.

Another simple step to bring some accountability to the system would be for the Internet Corporation for Assigned Names & Numbers, one of the Internet's few regulators, to require every domain to publish the name of a responsible individual with a physical address and a genuine phone number. Many now list no individual and only a post office box.

The Internet began life as a community and in some sense still is one. But communities that fail to sanction members who won't live by the rules do not survive. The Internet has to act to restore some civil order. Do you have an idea on how to do it? Send your suggestions to tech&you@businessweek.com. ■

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eSecurity: A High Priority

Deploying the Best Defense

Where to Focus Your eSecurity Action Plan

Information security is a high priority for business today. Cyber-terrorism increased dramatically in 2001, according to a study recently released by Riptech of Alexandria, Virginia. The study of 300 companies in 15 industries found that in the last six months of 2001, 138,000 attacks were registered, not counting the Nimble and Code Red worm viruses. The average attack experienced per company increased 79 percent in the period, according to Tim Belcher, CTO of Riptech, which specializes in security services.

The attackers were found to be directing their efforts toward selected company and industry targets as well, a surprising finding. Before the results were in, "We didn't think the attackers cared who the targets were," Belcher said.

In this new era of heightened awareness, experts advise taking the following actions to improve your company's e-security:

- **Install filtering technology** is installed at your company's Internet connection points so that incoming messages can be screened, and outgoing messages can be cleaned or encrypted.
- **Install software** to prevent malicious code from executing on your computer systems. These include virus protection, firewalls intrusion detection systems.
- **Consider authentication methods** stronger than a password system, especially if your company is involved in commerce over the Web.

- **Protect your company** from legal liability with secure content management methods such as screening e-mail that could be considered sexually harassing, and filtering unwanted spam e-mail.
- **Ensure your company's ability** to recover by replicating mission-critical data in multiple sites.
- **Tap professional services organizations** that provide the experience and knowledge to assist you with the technology and the set up of secure sites. A qualified staff is hard to hire, but it can be rented.

Companies can reduce the amount of harmful content coming into their companies by using Web filtering and blocking products.

Securing Content

Companies can reduce the amount of harmful content coming into their companies by using Web filtering and blocking products," said Chris Christiansen, analyst with IDC market researchers

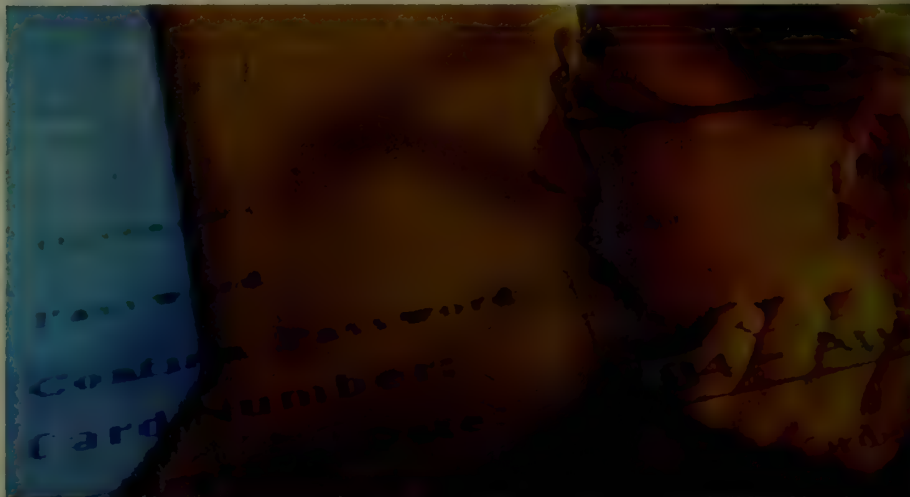
of Framingham, Massachusetts. "It can also prevent the creation of a sexually harassing environment and potential legal liabilities," he said.

A recent IDC report on secure content management found that the market is strong for products that screen workplace prohibited material such as hateful e-mails and sexually graphic files. While antivirus software products currently are the best sellers with \$1.8 billion in revenue projected from the segment in 2002, access control and e-mail scanning software products are projected to grow at a higher rate through 2005.

"We are seeing the convergence of e-mail and Web filtering," said K. Blakeman, president of the American of SurfControl (www.surfcontrol.com) based in Scotts Valley, California. "We see it as moving more and more towards filtering and content management, where we help produce policies for managing the flow of content through browsers and e-mail systems." SurfControl products allow users to scan the text of incoming and outgoing e-mail and determine actions based on rules that fit the business.

Securing Data

Commerzbank in New York City completed implementation of its business continuity solution on September 7, 2001. The company had no way of knowing what was to happen four days later.





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eSecurity: A High Priority

as a result of its planning, the world's 16th largest bank resumed operations quickly despite being 300 feet from the World Trade Center Towers. The company had worked to build a disaster recovery site 30 miles away in Rye, New York. Using replication software from EMC Corporation (www.emc.com), Commerzbank was backing up its critical data to the recovery site, thus enabling a quick recovery.

"The relationship of storage to security relates to how quickly a company can recover to a known good state after a security breach or corruption of data," said Ken Steinhardt, EMC's director of technology analysis. EMC supports business continuity for its customers with products and services addressing recovery, automation, software and hardware. By exploiting these offerings, "Commerzbank is now running 50 percent of its production data in each of two data centers," Steinhardt said.

Hot Topics

The following issues are top of mind in the e-security arena today, as the industry prepares for its biggest trade show, the RSA Security Conference scheduled for February 18-22 in San Jose.

■ **Confederated User ID:** Refers to an individual profile that can be recognized on multiple Web sites. Microsoft unveiled Passport, then an industry consortium proposed the Liberty Alliance and now the two are working together. True federated identity management is probably two to four years away.

■ **Web Access Management:** Rights and privileges a user has once entered into a system.

■ **Tokens, Tokens, Everywhere:** The use of a token system for confirming

the identity of a person or a company on the Internet – one step better than passwords – is gaining. RSA Security has delivered over 100 million tokens worldwide from its products.

■ **Biometrics:** Gaining steam as a method of authentication, including fingerprinting and eye scanning.

■ **Managed Services:** Trend of businesses hiring outside security experts to perform audits, draft security policies, monitor security systems, and respond to incidents.

Pitfalls to Avoid

In the quest to improve e-security, experts advised avoiding the following pitfalls:

■ Not changing default settings, especially passwords, on security products that you buy and install. Many firewall products, for example, have a default administrative password. Hackers can "listen" for those and break in when they find one. "If you don't manage

Many firewall products have a default administrative password. Hackers can "listen" for those and break in when they find one.



your security system, you create a weak link," said Scott Schnell, senior vice president with RSA, Bedford, Massachusetts.

■ Not being honest about the worst case scenario so you can plan for the right responses. Many companies plan for disaster recovery but underestimate the real world in their simulations.

■ Not identifying the truly mission-critical data in your company. The time to discover that the data is critical is not when it's unavailable.

Better protection is at hand. E-security can be vastly improved for a reasonable cost by following a pragmatic step-by-step approach. It will allow harried business managers to sleep better at night.

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BY ROBERT J. BARRO

THE STATE OF THE UNION: BUSH MOSTLY GOT IT RIGHT



VISION:
On the "axis of evil," the return to budget deficits, and accounting reform, the President has good ideas. But about those volunteers....

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

President Bush's State of the Union address touched on several important issues. Of course, nothing was more memorable than the characterization of Iraq, Iran, and North Korea as an "axis of evil." According to one Internet joke, other countries, such as Libya, China, and Syria, were upset at being snubbed. "They told us it was full," complained Syrian President Bashar al-Assad in the joke.

Humor aside, one way in which Bush's evil trio clearly stands out is in its dismal economic performance. Since Saddam Hussein took power in Iraq in 1979, the per capita gross domestic product has declined by 6% per year, the worst performance over that period for all countries for which data are available. In contrast, from 1955-79, the growth rate was 4% per year. Therefore, Saddam's military adventures have probably cost Iraq's citizens more than anyone else. Somewhat similarly, Iran grew under the Shah, Muhammad Reza Pahlavi (a favorite target of the world's leftists), at 4% per year from 1955 to 1978. Then, the growth rate became negative (minus 1% per year) after the Islamic Revolution. For North Korea, accurate data are unavailable, itself a telling indicator. However, North Korea was about as rich as South Korea after the Korean War, whereas today the South has a per-capita GDP that is more than 10 times as high.

Bush's State of the Union message also focused on the U.S. budget, which has been heavily influenced by the war on terror. The added military and security expenditures are major reasons for the budget deficit, and I agree that this deficit makes sense in an environment of recession and war. This fiscal stimulus also makes it likely that the recession has bottomed out.

Bush's proposed acceleration of tax-rate cuts would raise the odds of resuming economic growth. However, given the small chance of gaining approval for a well-designed tax-cut package, Bush is probably best off settling for no package and then blaming the Democrats. The November campaign slogan is likely to be: "You trust me on the war. Now trust me on the economy by electing Republicans to Congress."

In the State of the Union, Bush referred indirectly to the Enron Corp. scandal by advocating stricter accounting standards and disclosure requirements. Reforms along these lines could be helpful, but proposals from Congress seem to focus instead on limiting the percentage of workers' retirement plans that can be in the employer's stock. Shlomo Benartzi of John E. Anderson School of Management at the University of Cal-

ifornia at Los Angeles notes in the *October Journal of Finance* that many workers hold company stock in their 401(k) plans. So these holdings are required by employer. These constraints may make sense from standpoint of giving employees incentive to work.

However, workers also place lots of their retirement funds into company stock. As an extreme example, at Coca-Cola Co., 90% of pension plan assets and 76% of workers' 401(k) contributions are in Coke shares. Economists do not understand this because workers already have a big stake through their jobs in the profitability of their companies. But the ignorance of economists does not mean that workers, such as those at Coca-Cola, would benefit from having Congress restrict the rights to hold pension-fund assets in company stock.

In the Enron case, it is unclear that the workers would have benefited much from the right to sell company stock. There is no reason to believe that the typical employee would have sold to sell, given that no one knew that the price was headed toward zero. Moreover, a worker who had this foresight could have sold the short (or purchased puts) even if the direct selling of shares was prohibited.

My main objection to the State of the Union speech involves the part about volunteerism. We live in a country that owes its high standards of living and its thriving social and political institutions to a market economy. Nevertheless, President Bush apparently subscribes to the romantic notion that volunteerism is somehow better for society than working at a market job. Think, for example, about William H. Gates. For most of his career, he pursued profit through aggressive production and marketing of computer software. Compare this with Gates' charitable and volunteer activities, which include aid for health care in Africa. Is it conceivable that the average person will benefit more from this volunteerism and charity than from Gates' profit-seeking activities at Microsoft Corp.? As Smith answered this question a long time ago as a general tendency, it is better if people liberate themselves from self-interest than from a desire to serve the public good. So volunteer work may be a route to self-fulfillment, but it is not an especially great thing for society.

However, I should not complain too much about the speech. Most of it was good, and I never, even once, used the fluffy expression "passionate conservatism."

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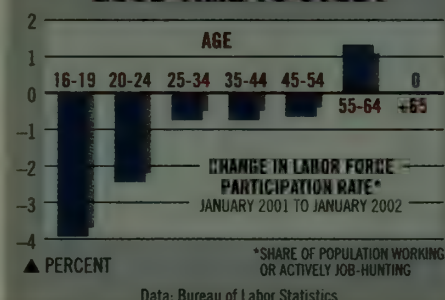
EDITED BY MICHAEL J. MANDEL

CLIMBING OUT OF THE JOB POOL

More young workers opt for school

It's not unusual for some unemployed workers to stop looking for jobs during a recession. But in this downturn, the retreat from the work force has turned into a mass exodus. The latest report from the Bureau of Labor Statistics showed that the labor force participation rate—the percentage of people

BAD JOB MARKET, GOOD TIME TO STUDY



either employed or actively job-hunting—fell by 0.8 percentage points over the past year, to 66.4%. That's the biggest year-over-year drop since the early 1960s.

The sharp decline suggests the published unemployment rate understates the damage to the labor market, since people not looking for work are not counted as unemployed. The understatement is particularly bad for the young, among whom the withdrawal from the labor force has been concentrated so far (chart).

Consider the unemployment rate for males ages 20 to 24, which rose to 10.6% in January, 2002, from 7.7% in the same month in 2001. That's bad enough, but over the same period the percentage of this group working or looking for work plummeted from 82.9% to 80.3%. With the exception of one anomalous month in 1999, that's the lowest participation rate on record for this group. If the withdrawn workers are added back into the numbers, the unemployment rate for this age group would be much higher. The situation for young women is similar, but not as extreme.

What's happening is that young workers, facing a bad labor market, are going back to school. BLS figures show that the percentage of young people enrolled

in school rose substantially over the last year. By contrast, older workers seem to be in greater demand, rather than less, and more eager to work. The unemployment rate for workers 55 and older has gone up less than a percentage point, even while the pool of older workers in the labor force has expanded (chart). For example, the number of people ages 55 to 64 in the workforce rose 6.8% over the past year. That's a switch from the last recession, when older workers were more likely to be laid off. This time, older workers seem to be a resource rather than a burden, while it's the young who are taking the hit.

WHEN CITIES ARE TOO SMALL

A study eyes size vs. productivity

Urban economists have long theorized that there is an optimal size for a city to maximize the productivity of its workers. Up to a certain size, the economies of scale afforded by urban infrastructure improve productivity. But once a city gets too large, congestion can actually cause productivity to drop.

The problem was that finding city-by-city data on productivity to test the theory was very hard. However, it turns out China keeps track of detailed output data for almost 700 of its largest cities. Using the data, a new study by Chun-Chung Au and Vernon Henderson of Brown University estimates the optimal size for city productivity, taking into account the relative proportion of manufacturing vs. services.

They found that the best size for a Chinese city with an equal balance of services and manufacturing would be between 1.4 million and 2.6 million workers. Cities that were more dependent on manufacturing would be most productive at a smaller scale, while services-based cities would benefit from being larger, perhaps between 2 million and 4 million workers. (These estimates for China are unlikely to apply to the U.S. Nevertheless, for a point of comparison, New York, one of the most heavily services-dependent U.S. cities, has a workforce of roughly 3.5 million.)

Surprisingly, Au and Henderson found that rather than suffering overcongestion, most cities in China were actually too small compared with their optimal scale. They attribute this to Chinese governmental policy restricting internal migration.

By Margaret Popper

STEEL TARIFFS: FOR AND AGAIN

Economists make opposing calls

These days, economic studies become essential to any good lobbying effort. But their advocacy has rarely been so blatant as in the going fight over steel imports. The U.S. International Trade Commission in December recommended that on imported steel, it triggered a set of competing economic reports, with directly contradictory results.

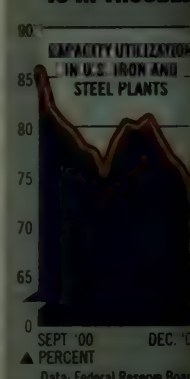
On the one side were economists by the Consuming Industries Trade Action Coalition (CITAC), a group of steeling companies and industry groups including Caterpillar Inc. and Toyota Motor Manufacturing North America Inc. In a study, by Joseph F. Francois and I. M. Baughman of Trade Partners Worldwide LLC, concluded that tariff on imported steel would boost prices cost between 36,000 and 75,000 jobs across the economy, eight times the number of steel industry jobs saved. Moreover, the CITAC study claimed the tariff would cost consumers between \$2 billion and \$4 billion.

The steel industry fired back with a counterstudy by Massachusetts Institute of Technology economist Jerry Hausman, renowned for his work on telecom deregulation and antitrust. Hausman argued that CITAC's study underestimated the amount of American steel that could be substituted for imports. With U.S. steelmakers operating at two-thirds capacity, it would be hard for domestic producers to fill the supply gap caused by restricting tariffs (chart). As a result, "the cost of domestic automobile would increase less than \$2," writes Hausman.

With CITAC responding with its critique of Hausman's critique, the truth is hard to figure. The U.S. steelmakers are clearly under serious stress. But it's likely that they would be far better helped by a revival of the U.S. economy than they would be by tariffs on foreign steel—and that's not captured in either study.

By Margaret Popper

THE STEEL INDUSTRY IS IN TROUBLE



JAMES C. COOPER & KATHLEEN MADIGAN

SLUMP AND A RECOVERY IN INTERNET TIME

How high-tech advances are helping to shape the rebound

U.S. ECONOMY

At his semiannual monetary policy report to Congress a week ago, Federal Reserve Chairman Alan Greenspan made a point of explaining how unusually quick reaction times by businesses and policymakers shaped the economic slowdown. When Greenspan travels to Capitol Hill for this year's testimony on Feb. 27, it will be interesting to see if, in forecasting the shape of the recovery, he cites that same time compression as a factor. As Greenspan has noted, rapid response times are a result of technological advances. Increased use of real-time information, such as computerized order tracking, enables business to know when demand is shifting and to instantly change output schedules, workshifts, inventory levels, and capital spending plans. Like increased productivity and greater labor flexibility, quick reflexes became a key characteristic of the U.S. economy during the 1990s.

WHY PRODUCERS REINVEST IN THEIR INVENTORIES



These New Economy phenomena will affect this year's upturn, too. Already, capital spending is showing signs of stabilizing as companies invest in high-tech equipment in order to keep productivity growing. Also, unemployment will rise this year even as real-income gains amid low inflation give many households greater buying power to keep consumer spending on the rise. Most important, shorter reaction times will play a big role in this year's inventory cycle. With demand growth at least at a modest pace, businesses in early 2002 should not continue to cut their stock levels as drastically as they did in late 2001. Tech inventories in particular have fallen far enough so that they are better aligned with the drop-off in tech sales (chart). This slowdown in inventory liquidation may mean that economic growth in the first half of 2002 could be much stronger than what economists now anticipate.

SEE HOW rapid responses have changed the way the economy works, you need only look at last year's recession. The quick availability of information on slow-demand caused businesses to cut their inventory levels at an unprecedented rate in 2001. The drawdown in business inventories accounted for all of the

contraction in real gross domestic product last year.

At the same time, officials at the Fed and the White House reacted in record time to supply the economy with stimulus in the form of lower short-term interest rates and tax rebates. St. Louis Fed President William Poole noted in a Feb. 13 speech that the Fed began reacting before the recession began, partly because of anecdotal reports of falling loan demand. He said such reports allow the Fed "to see what is going on in the economy almost as it is happening."

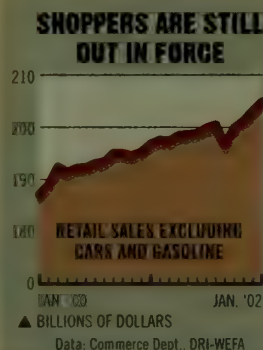
The rate cuts helped to push down mortgage rates, which fueled record home sales last year—a pickup that never occurred in any previous recession. The tax rebates gave consumers the money to keep spending in each quarter of this recession: another unprecedented occurrence. All told, the quicker response times were crucial in making this recession unlike any other in the postwar era.

That alacrity should likewise make for a unique recovery. Its influence will be felt most keenly in inventories. Thanks to real-time information, companies can quickly refigure the appropriate levels of merchandise and supplies to have on hand. And companies don't have to rebuild inventories to contribute to economic growth in 2002: In GDP arithmetic, even a slower rate of liquidation means a big plus for economic growth.

For example, if inventory liquidation slows from its \$121-billion fourth-quarter pace to zero by the second quarter, as some forecasters expect, that swing would add, on average, a huge 2.5 percentage points to GDP growth in both the first and second quarters.

OF COURSE, COMPANIES will only realign their inventories if they believe that demand prospects have improved. So far, demand, especially from consumers, has remained steady. The end of lucrative financing deals caused a drop in car sales in January, which pulled down total retail sales by 0.2% for the month. But excluding vehicles, retail buying jumped 1.2% in January. Outside of the recent ups and downs in sales of cars and gasoline, buying began the first quarter far above its fourth-quarter average (chart).

Although consumers have increased their shopping



during this recession, they have also cut back on their credit-card use. Installment credit slipped by \$5.1 billion in December. The drop-off has been concentrated in revolving debt, mostly on credit cards (chart). Installment debt peaked last summer, suggesting that consumers used part of their tax rebates and general increase in purchasing power to pay off existing debts at a quicker rate than they have in past recessions.

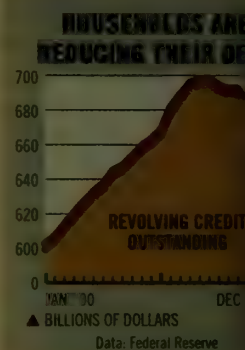
THE TIME SQUEEZE may also be widening the divide between business spending on high-tech equipment and outlays for more traditional capital goods. That gap showed up in the fourth quarter, when investment in tech equipment edged up slightly for the first time in a year, while spending on old-line investments—such as turbines and rail cars—fell. Outlays for industrial equipment dropped at an 11.6% annual rate, with spending on transportation equipment down 5%.

The gap may get bigger in 2002. New orders for computers and electronic products grew at a 20.1% annual rate from the third quarter to the fourth. But noncomputer, nondefense capital goods dropped at a 28.7% pace. The divergence may reflect fresh reasons for investing in today's economy: Instead of adding capacity, companies are buying tech goods in order to increase productivity and lower costs. That's the only profit-building strategy that will work this year, when pricing power again will be a no-show.

Moreover, faster depreciation for most tech equipment compresses the buy-and-replace cycle for this category of capital spending.

Historically, capital spending has lagged the rest of the economy. But like everything else in this business cycle, that old rule of thumb may not apply in 2001, at least not where tech is concerned. Business investment for computer equipment slowed before the rest of the economy did, and it may well pick up before other sectors because of the different imperatives that underlie the spending plans of today's companies.

How much Chairman Greenspan uses his upcoming congressional visit to contrast this business cycle with others remains to be seen. He may well spend the bulk of his testimony explaining the possible economic consequences of the Enron debacle and questionable accounting practices. But the economy's 1990s metamorphosis played a part in the recession, and it will influence this year's recovery. Whether the Fed chief mentions it or not, a key aspect of the recovery will be quicker response made by businesses, consumers, and policymakers to shifts in the economy.



MEXICO

BRACING FOR A WAVE OF FOREIGN INVESTMENT

Mexico is still mired in a recession, but spirits are high following Standard & Poor's Feb. 7 upgrade of the country's sovereign-debt rating to investment grade. The move will cut government and corporate borrowing costs and should make the country more attractive to foreign investors, who are expected to pour at least \$20 billion into Mexico in 2002.

Moody's Investors Service had upgraded Mexico in 2000, but S&P waited to see if President Vicente Fox could win approval of an ambitious tax reform in December. Congress gave Fox about half of what he asked for. Mexico, with one of the lowest tax-collection rates in Latin

America, remains dependent on volatile oil exports for a third of government revenues. S&P said its decision was "a difficult call," but it applauded the government's fiscal discipline during the recession.

THE CENTRAL BANK HAS INFLATION UNDER WRAPS



Mexican officials know they must not let down their guard. Some analysts worry that a rush of new foreign investment will further strengthen the peso, which rose some 5% vs. the U.S. dollar in 2001, hurting export competitiveness. Unit labor costs rose 12% in the past year, compared with 2.2% in the U.S., as wage growth exceeded gains in productivity and prices.

The central bank's goal is to cut inflation to U.S. levels by 2003 by

clamping down on liquidity, which will also buoy the peso. The rate on 28-day Treasury bills, or Cetes, is 8.21%. Consumer prices rose 4.4% last year, below the official 6.5% target, with this year's goal at 4.5%. Mexico's economy shrank by about 0.3% in 2001, after growing 6.9% in 2000. This year, officials are counting on a U.S. recovery lift growth to 1.4%.

Closer U.S.-Mexico industrial integration means that Mexico is increasingly seen as part of North America, not Latin America, which is a big plus after Argentina's meltdown. Its main challenge is continued structural reform that will set it farther apart from its Latin peers. Next on the agenda: energy reform that could attract billions in new investment in natural gas and electricity.

By Geri Smith in Mexico City



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THEY SHOPPED—NOW THEY'VE DROPPED

Many companies whose M&As lit up the '90s are taking on water

During the go-go 1990s, WorldCom's Bernard J. Ebbers and Tyco International's L. Dennis Kozlowski were the heroes of a new breed of growth-driven CEOs. Unlike other chief executives who viewed mergers as a complement to their core businesses, this new generation viewed dealmaking as the cornerstone itself and the basis for maintaining heady growth rates. And while other CEOs might view a rising stock price as a nice reward for their labor, to executives like Ebbers and Kozlowski, keeping the stock price high was critical to their formula because it gave them the currency to keep their spending sprees going.

Now, of course, many of the celebrated dealmakers of the '90s have run into a brick wall. With Wall Street suddenly turning a cold eye toward the aggressive acquisitions accounting and leverage that drove much of the growth of the past decade, such acquisitive highfliers as WorldCom, Tyco, and Consecro have fallen out of favor with investors. According to a study by Bridgewater Associates Inc., the 20 companies with the greatest merger-and-acquisition activity over the past four years, a group that includes Cisco Systems, AT&T, and even General Electric, are now being punished by Wall Street. Through Feb. 4, their

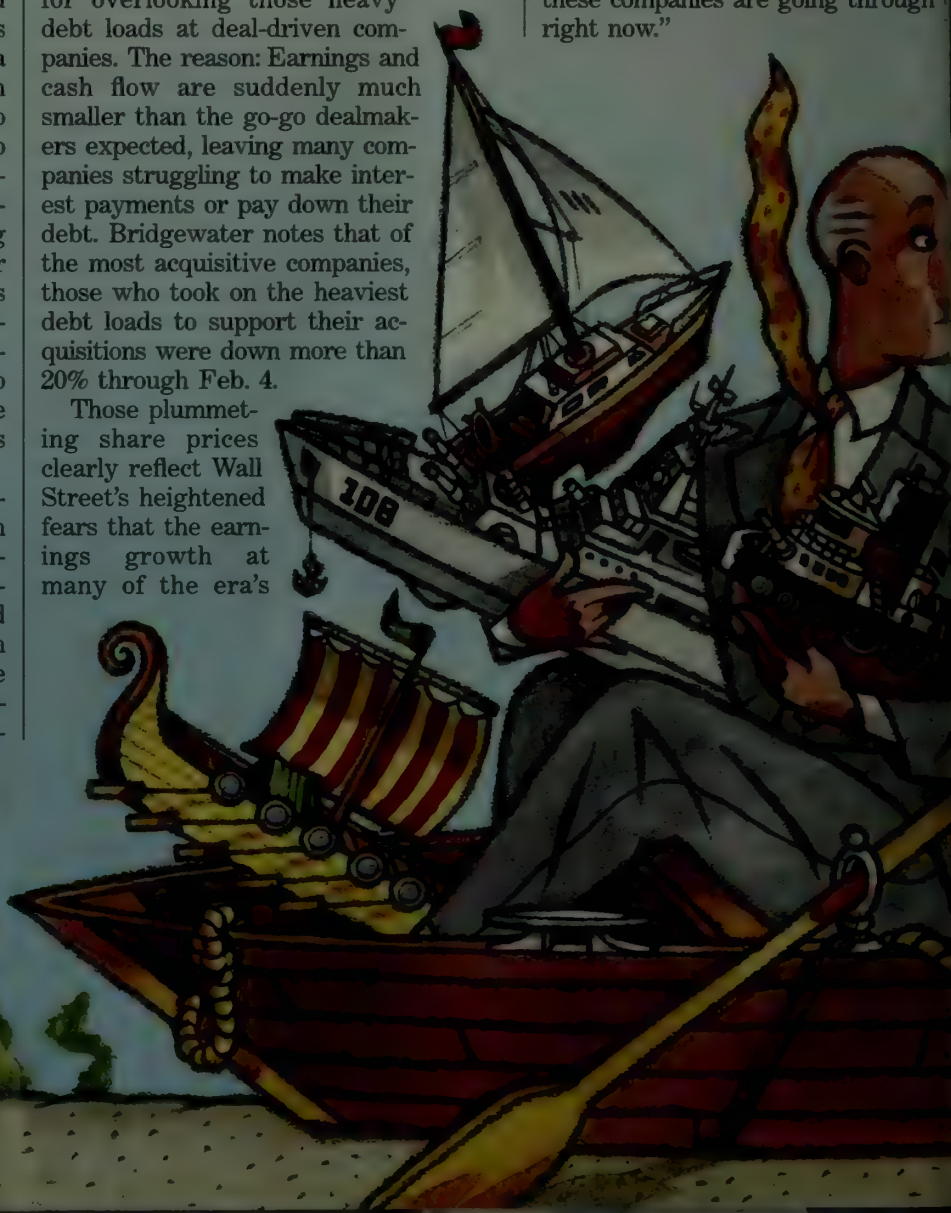
stocks were down an average 15% since the beginning of 2002, compared with a decline of 5% for the companies in the Standard & Poor's 500-stock index.

Aggressive dealmakers who also took on huge debt loads, convinced that rapid growth rates would never slow, are faring even more poorly in the harsh light of a slow-growth, post-Enron world. With accounting practices coming under close scrutiny, Wall Street has lost its appetite for overlooking those heavy debt loads at deal-driven companies. The reason: Earnings and cash flow are suddenly much smaller than the go-go dealmakers expected, leaving many companies struggling to make interest payments or pay down their debt. Bridgewater notes that of the most acquisitive companies, those who took on the heaviest debt loads to support their acquisitions were down more than 20% through Feb. 4.

Those plummeting share prices clearly reflect Wall Street's heightened fears that the earnings growth at many of the era's

biggest acquirers may not in fact been as strong as it once appeared and it certainly can't be kept up.

Investors now focused on "qual earnings" are raising questions whether accounting gimmicks have allowed serial acquirers like Tyco International Ltd. to inflate their earnings. "The growth-by-acquisition game is over," says Sam Rovit, head of Bain & Company's merger integration practice. "Many of these companies are going through a rough time right now."



lead, after a decade of record activity, the abrupt collapse of firms such as Tyco, WorldCom, and

ENRON BEYOND

Enron has thrown a monkey wrench into a deal machine that was already depressed by the recession and stock

market downturn. "The fallout from Enron is having a chilling effect on the market to merge," notes Morgan Stanley Witter & Co. strategist Joseph P. Tan. He points out that the \$18 billion announced deals in January was the lowest level since 1995. To get a deal done today, investment bankers say companies must be willing to pay in cash, take on less debt, and accept the aggressive accounting employed by the likes of Enron.

In the 1990s, when growth was about using mergers to fuel growth, many experts believe the coming decade will mark a return to a more old-fashioned notion of growth. Companies will shed many of their unprofitable acquisitions and focus on generating internal growth from businesses that they know best. This decade is going to be about getting back to basics, with companies focusing on markets where they have a global leadership position," says Douglas L. Braunstein, head of global mergers and acquisitions at J.P.

Morgan Chase & Co.

Already, it is happening: In late January, Merck & Co. said it was spinning off its Medco pharmacy benefits unit to focus on its development business. And on Feb. 1, DuPont Co. said it was planning either a sale or initial public offering of its \$6.5 billion textiles and interiors business.

But for many of the

go-go dealmakers, the future is more grim. They are facing, at best, slow growth and, at worst, the need to strip away at their empires to service their crushing debt loads. Even in once-hot Silicon Valley, where companies such as Cisco Systems, JDS Uniphase, and Ariba used their stratospheric stock prices as a convenient currency to buy the revenues of other companies, many are finding they can no longer use mergers to fuel easy growth.

The case of Commerce One Inc., a business-to-business software company, is all too typical. The company used its rising stock value—which soared above \$140 in early 2000—to fund five acquisitions that quickly catapulted its revenues to nearly \$400 million. With its stock currently below \$2 a share, Commerce One Chairman and CEO Mark B. Hoffman admits the days of acquiring growth on the cheap are over. "It's changed from what we were doing before, which was grow, grow, grow the company as quickly as you can, gain market share." Now, he sighs, "it's going to be much more like old, historical growth."

But for other companies, the pressures are more intense. Particularly vulnerable are those that spent freely when times were fat but are weighed down with stiff interest payments and heavy debt loads now that their growth has slowed. After spending a hefty \$17 billion to acquire other pulp and paper makers in recent years, Atlanta-based Georgia-Pacific Group is struggling with \$12 billion in debt in the middle of a sharp downturn in many of its core markets. Georgia-Pacific executives insist that the company is not facing a liquidity squeeze. Still, analysts think that Georgia-Pacific will likely have to sell or spin off some assets to remain in compliance with its lending covenants.

For other companies, the problems stem from acquisitions that haven't worked. Among them is Consecro Inc., the Indianapolis-based financial-services firm that, under then-Chief Executive Steven C. Hilbert, swung dozens of deals during the 1990s. But its biggest deal, the 1998 purchase of Green Tree Financial Corp. for \$7.6 billion, hasn't panned out. And Consecro is struggling to service its debt. Given Consecro's deteriorating cash position, "it's going to be difficult for them" to

make good on the \$1.1 billion in debt payments due later in 2002, says Salomon Smith Barney analyst Colin W. Devine.

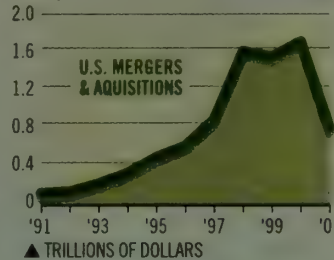
Consecro executives clearly disagree. They insist that they have already taken aggressive action to bring down debt, and they say the company plans to raise an additional \$750 million through the sale of portions of its insurance business and other assets. The company has also repurchased \$266 million in bonds at a 30% discount in the secondary market. "Liquidity is not an issue," says Consecro's current chief executive, Gary C. Wendt. But having already sold \$1.6 billion in assets—and with an additional \$6 billion in debt still on the books—some investors and analysts wonder whether Wendt will ultimately run out of things to sell.

"There're hardly any assets left there," notes Devine.

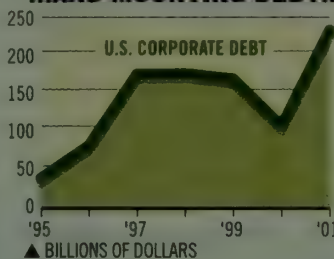
It's too early to tell how many other companies will fall as hard or as fast as the Tyco, WorldComs, and Consecros. Still, as the corporate heroes of the deal-crazed 1990s fade away, there's no doubt that they'll be taking with them their now-repudiated business model. No more deals for deals' sake alone. At least, not for some time to come.

By Dean Foust, with Aixa Pascual, in Atlanta, Pallavi Gogoi in Chicago, Jim Kerstetter in San Mateo, and bureau reports

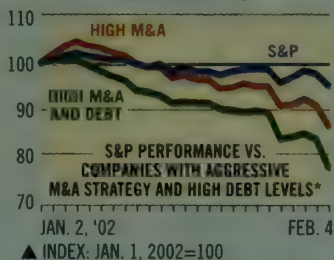
A DECADE OF DEALS...



...AND MOUNTING DEBT...



...ARE COMING HOME TO ROOST





SKILLING ON THE SKILLET

Well, at least he said something, seeing a string of top Enron executives invoke their Fifth Amendment rights, a congressional subcommittee Feb. 7 gave former CEO Jeffrey Skilling credit for actually testifying. But his I-know-nothing "Sergeant"



Did Skilling know that off-balance-sheet partnerships involving then-Chief Financial Officer Andrew S. Fastow and other execs were hiding losses and inflating earnings?

WHAT OTHERS SAID: Documents from a May 1, 2000, meeting of the board finance committee, attended by Skilling, showed that a presentation about one of the off-balance-sheet vehicles, Raptor 1, specified that it "does not transfer economic risk but transfers profit and loss volatility."

Furthermore, a document presented

during an Oct. 26, 2000, meeting with investors in Fastow's so-called partnerships made it clear that Skilling was accelerating earnings recognition. Enron was one of the purposes of the partnerships.

Skilling's attorney confirmed that Skilling gave a speech at the meeting.



Did Skilling ignore warnings about problems at the partnerships?

WHAT OTHERS SAID: Former Treasurer Jeffrey McMahon said he told Skilling on March 16, 2000, in a 30-minute meeting, that in having to represent Enron in negotiations with Fastow—his boss and a partnership owner—he felt pushed to do deals not in shareholder interests. McMahon was soon offered a new job at Enron. Whistleblower Sherron S. Watkins

said former Vice-Chairman J. Baxter, who recently committed suicide, complained "mightily" about Skilling about the partnerships.

WHAT SKILLING SAID: He was warned about accounting or other problems in the partnerships, but he disputed the others' characterization of the warnings. He recalled



But wasn't Skilling supposed to oversee the troubling partnership deals?

WHAT OTHERS SAID: Board members Robert K. Jaedicke and Herbert S. Winokur Jr. testified before Congress that they thought Skilling was supposed to review the deals as part of Enron's control process. Minutes of an Oct. 6, 2000, finance committee meeting show that Fastow told the

board that Skilling's approval was required for the controls.

WHAT SKILLING SAID: He was required by the board to review and approve all transactions done by Fastow's partnerships. Moreoever, he said he "can't recall" the partnership



Why didn't Skilling sign deal-approval sheets involving LJM transactions?

WHAT OTHERS SAID: Enron lawyer Jordan Mintz said he wrote Skilling seeking his signature on LJM deal-approval sheets—which he believed policy required. Skilling never

responded. Calls to Skilling's office for a meeting were also ignored.

WHAT SKILLING SAID: He didn't see the documents or Mintz's



Did Skilling allow other Enron executives to be involved in the partnerships, in violation of the company's code of conduct?

WHAT OTHERS SAID: At least one deal-approval sheet shows that Enron finance executive Michael J. Kopper was negotiating on behalf of the LJM partnership against Enron, apparently in violation of the company's code of conduct. Furthermore, a private

placement memorandum for Kopper indicated that Kopper and Bevilacqua Glisan Jr., another senior Enron financial officer, would be acting as owners and managers of the partnership.

Was Skilling involved in restructuring the Raptor vehicles, which let Enron avoid \$500 million in pre-tax charges?

WHAT OTHERS SAID: According to the board committee's report, evidence from some senior Enron employees showed Skilling was aware of the problems and was "intensely interested" in the resolution of Raptors' issues.

He even called one of the accountants working on the restructuring to thank him when it was completed.

WHAT SKILLING SAID: He told the board's investigators he was involved

defense, as one Congressman raised far more questions than d. Now congressmen want explain the inconsistencies between he and others are saying. Here places he might start.

By Wendy Zellner in Dallas

SKILLING SAID: "I was not aware of any arrangements designed to manipulate abilities or inflate equity," he testified. He didn't discuss about Raptor not taking risk at the May meeting and did not see the documents at that meeting, which he attended privately.

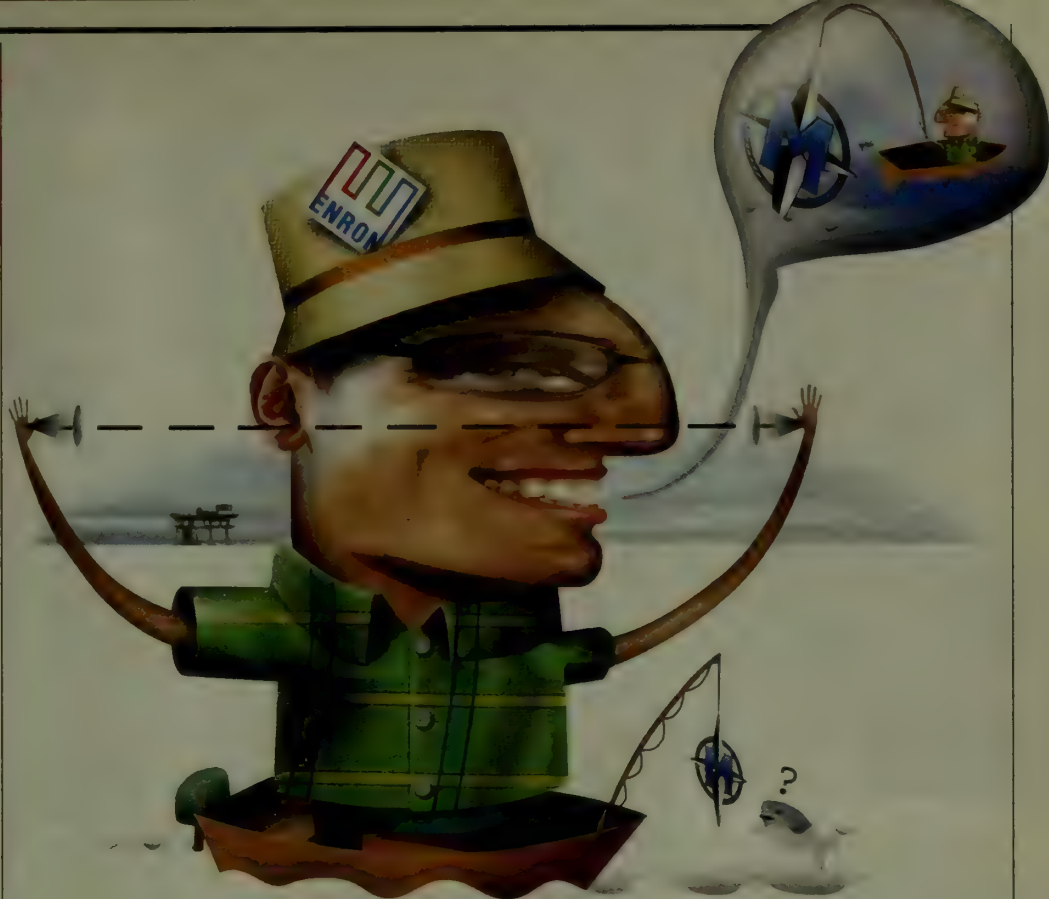
had "some concerns about compensation" because Fastow affected his review and bonuses. He resisted McMahon's "promotion" related to his LJM complaints. He recalled only one talk with McMahon about the deals. While Baxter told related-party transactions to Skilling, Skilling said Baxter knew of deals with the partnerships.

committee meeting where deals were discussed. He noted that McMahon had gone out and the room was empty for some period. His lawyer was 10 minutes from prior board meeting and a recent report by a board committee detailing deals that did not include Skilling.

and since the deals were already approved by Mintz wrote his letter, his signature wasn't needed. He also signed the approval sheets "provided" by McMahon, but did not require it.

SKILLING SAID: He did not know about McMahon, Glisan, or other Enron executives who had financial stakes in some of the partnerships. He testified that he knew that Kopper was involved in some of them.

generally about the Raptors' deals and had no real involvement. In Congress he may have called McMahon an accountant, but when asked if he approved Raptor's restructuring, he replied: "Not to my recollection."



INVESTIGATIONS

ENRON'S FISH STORY

Was Mariner a "tool for earnings management"?

In May, 1996, Enron Corp. invested in a little-known oil-and-gas explorer called Mariner Energy Inc. Based in a Houston suburb, the private outfit specialized in risky deepwater drilling. Its vast unproven fields in the Gulf of Mexico could be worthless or a potential goldmine—a quality that made Mariner a perfect vehicle for potential financial manipulation, according to several former Enron employees.

Every quarter, Enron's internal accountants recalculated Mariner's value, and nearly every quarter it went up. By November, 2001, Enron estimated that the value of its 75% stake had risen to about \$350 million, nearly double the original investment. As those gains accumulated, they were applied straight to Enron's operating income—helping to ignite its seemingly explosive financial performance.

But like much else at Enron, the Mariner investment may not have been

what it seemed. Executives inside a key internal control unit, the Risk Assessment & Control Group, felt its soaring book value was overstated, according to several ex-employees. They waged an unsuccessful war to have Mariner's value marked down. In November, says one member of the unit, an informal RAC study valued Enron's Mariner investment at about \$150 million. "There were endless meetings fighting about how this deal should be valued," says another former RAC employee, Ogan Kose.

If it seems as though all of Enron's accounting tricks have already been exposed, guess again. Ex-employees say Mariner is part of a larger story that still hasn't fully come to light: They allege the company overstated the values of its investments in several private domestic companies in order to bolster Enron's overall financial performance. At a time when former lead-

ENRON & BEYOND

ILLUSTRATION BY KEVIN CURRY

ers Kenneth L. Lay and Jeffrey K. Skilling are trying to blame the company's problems on a small group of rogue financial execs, the details of Enron's investment portfolio indicate the company's problems went well beyond the CFO's office—and well beyond its controversial off-balance-sheet partnerships (page 118). "The investments were the responsibility of a fairly large number of people throughout the organization," says Bala G. Dharan, a professor of accounting at Rice University's School of Management, who has studied Enron's portfolio. The possibility that games were played with the investments, he says, "gives the impression

high-ranking executive says that at its peak, in late 1998, the domestic portfolio of public and private investments in Enron North America, ECT's successor, was valued at about \$1.5 billion. These holdings included a shifting array of 25 to 50 private companies. According to one former RAC employee, the private companies in this portfolio other than Mariner were overvalued by \$50 million to \$75 million.

While the company boasted about the performance of its investments externally, a different picture was painted internally. According to Kose, executives at an RAC meeting told other members of the unit in the summer of

submit a proposed valuation for M to RAC at the end of each quarter. The RAC unit was supposed to have power to modify the numbers if that the valuation was too high.

reality, RAC staffers say the system didn't work. Enron's performance-review system gave dealmakers the authority to evaluate the RAC per-

who were reviewing their deals—practice that made it risky to challenge aggressive investment valuations. Moreover, two RAC employees say that they complained about investment valuations, the head of their unit, Risk Officer Richard B. Buy, backed them up. Buy is also a member at Mariner. He and his attorney both declined to comment.

Unlike Enron's dealmakers, RAC employees would not directly benefit from the value of the company's investments inflated. Many say that they frequently complained about how their sophisticated financial analyses were discarded out of frustration, they decided to take a different approach to valuing the company's outside stakes starting in 2000. Rather than simply rubber-stamping the investment valuations provided by the company's business units, as had been pressured to do in the past, they decided to start offering value "ranges" for the company's investments. The range for Mariner, for instance, was \$80 million to \$350 million, according to one RAC source.

Little changed, though, as the company almost always took the highest possible valuation. But the RAC employees believed it was making a point. "If we were marking [the valuation] to whatever number they wanted for book purposes, we didn't want to be responsible for that number," says another former RAC manager. In retrospect, it seemed a hollow victory. The public never benefited from accurate valuations, and the larger battle—to ensure that Enron properly reported the performance of its investments—was clearly lost.

By Mike France in New York, Wendy Zellner in Dallas

ENRON & BEYOND



Employees say their boss, Buy, who is also on Mariner's board, rarely backed their complaints that valuations were inflated

CHIEF RISK OFFICER BUY TESTIFYING BEFORE CONGRESS ON FEB. 7

that the accounting problems were symptoms of wider cultural problems [within Enron]."

Enron and Mariner both declined to comment. "We'll let the process of investigation currently under way take its course," says Enron spokesman Mark Palmer. And one high-ranking Enron executive argues that Mariner is a profitable company with good prospects. In 2000, it earned \$21 million on revenues of \$121 million. He added that with Mariner, as well as many of the company's other private investments, "there's room for disagreement as to what the carrying value should be."

Enron began building a portfolio of investments in public and private companies in the early 1990s. The majority of the deals were engineered by Enron Capital & Trade Resources, the dynamic unit then run by future CEO Skilling. He intended the investments to bolster the company's efforts to develop a broad, diversified commodities-trading business. In order to assure a reliable supply of the assets being traded, Enron took stakes in Mariner, paper manufacturer Kafus, steelmaker Qualitech, and the publicly traded Internet service Rhythms NetConnections, among others.

The exact performance of the company's investments is impossible to track because Enron is not required to report it separately. But one

2001 that 70% of Enron's investments had failed to meet their internal performance targets. The summer meeting "was supposed to be secret," says Kose. "They purposely did not distribute any documents."

Of all of Enron's private investments, Mariner was the most overvalued, according to several inside sources. Because it was one of Enron's biggest stakes and because of the innate unpredictability of deepwater drilling returns, it turned into "a pretty decent tool for earnings management," alleges one RAC source. Noting that the valuation model for Mariner was "highly tweakable," another RAC employee says it was easy to inflate the investment by changing assumptions about the productivity of deep-sea acreage or the long-term price of oil and gas.

How did the manipulation occur? In theory, ex-employees say, the business unit that managed the Mariner investment (which was shuffled among divisions as Enron restructured) would first

MORE ACCOUNTING GAMES?

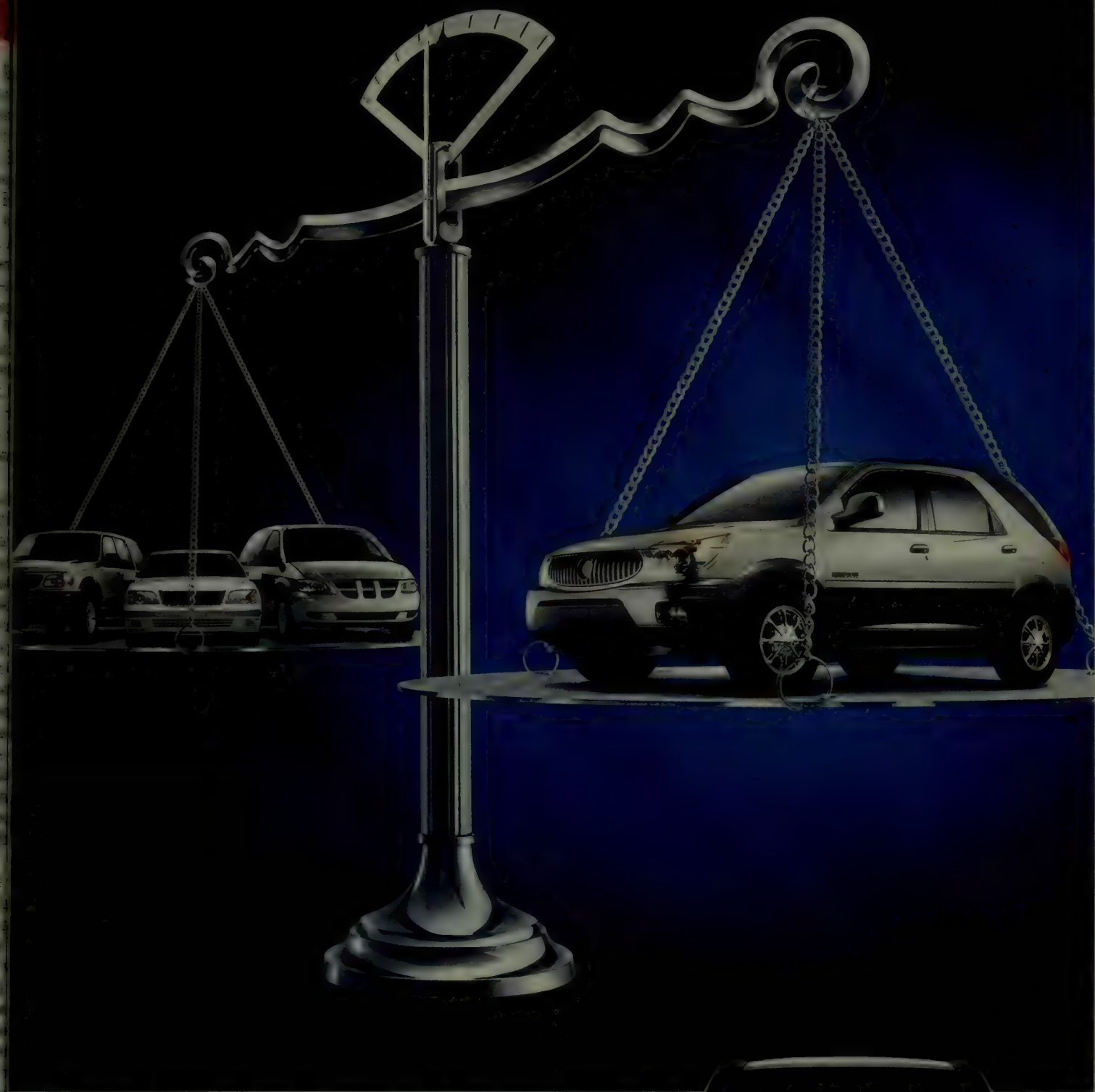
Several former insiders allege that Enron inflated the value of its investment portfolio using the following tricks. The company declined to comment.

BOGUS VALUATIONS

Ex-employees say the value of Enron's stake in private deepwater driller Mariner Energy ballooned by using overly generous assumptions about potential reserves and long-term oil-and-gas prices.

DISCARDED CONTROL

The Risk Assessment & Control unit was supposed to be able to modify investment valuations if they were too high. But insiders say top brass often ignored RAC's financial analyses.



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DEALS

BEHIND TYCO'S ACCOUNTING ALCHEMY

The CIT acquisition offers new insight into how the company produced huge pops in profits

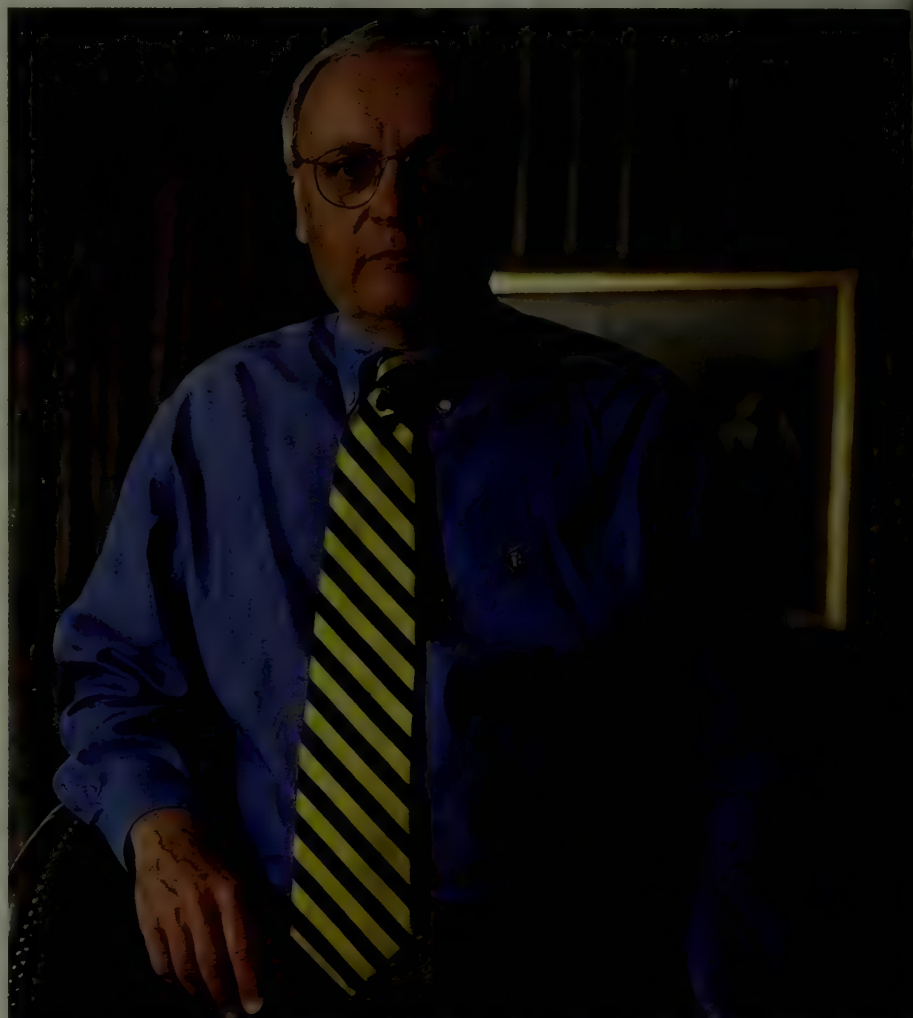
Last March, Tyco CEO L. Dennis Kozlowski stunned even some of his staunchest supporters by offering \$9.5 billion to buy CIT Group, then the nation's largest independent commercial-finance company. Skeptics worried that Kozlowski's industrial conglomerate would get burned venturing into a risky area it knew nothing about. But Kozlowski scoffed, arguing that he would rev up CIT's growth. "I think CIT will be one of the best deals we've ever done," he told *BusinessWeek* just before the purchase was finalized.

Today, CIT looks like the worst deal Kozlowski ever closed. Rather than help transform Tyco International Ltd. into another General Electric Co., as Kozlowski had hoped, CIT has become an albatross that is hastening its breakup. When Tyco's plunging stock price helped force a downgrade of CIT's credit rating, CIT was forced out of the commercial-paper market, its very lifeblood. The move caused CIT and Tyco to swap their \$13 billion in commercial paper for pricier bank loans and heightened fears of a liquidity squeeze. Now Kozlowski is scrambling to cut CIT loose any way he can—through a sale or outright hand-over to shareholders—no later than June. "Nearly everyone accepts that they will take a multibillion-dollar loss" on a sale, says Barry Bannister, an analyst at Legg Mason Inc.

Even as Kozlowski moves to shed CIT, its financials are providing new insight into how Tyco itself operates. Critics say the CIT deal presents a rare glimpse into how Tyco has managed to "spring-load" its results—producing a huge pop in profits right after an acquisition closes. Alone among Tyco's ma-

CIT'S GAMPER

He needs a clean break from Tyco—and soon



major acquisitions, CIT continues to file financial reports with the U.S. Securities & Exchange Commission because of its reliance on the public debt markets. Those reports disclose that in its first four months under the Tyco umbrella—from June 2 to Sept. 30, 2001—CIT generated \$252.5 million in net income. That's more than three times the \$81.3 million CIT earned in its last five months as an independent public company, from Jan. 1 to June 1. "This is one of the most startling examples of financial engineering you can hope to find," says Albert J. Meyer, an analyst at David W. Tice & Associates and longtime critic of Tyco's accounting.

Tyco vehemently rejects this accusa-

tion, and in an interview with *BusinessWeek*, the company countered the charge leveled by Meyer and other critics. CIT CEO Albert R. Gampe maintains that thanks to Tyco's move, his company is stronger today. Under the aegis of Kozlowski—a renowned dealmaker whom Tyco rewarded with a rich re-

retirement package (page 142)—CIT has slashed some 1,000 jobs while consolidating operations to save a total of \$160 million in operating expenses, says J. McGee, a Tyco executive vice-president who was dispatched to CIT after the deal closed. At the same time, Tyco prodded CIT to either sell or liquidate some \$5 billion in poorly performing

**ENRON
& BEYOND**



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loans on recreational vehicles and other goods. McGee says these actions, along with falling interest rates, account for CIT's startling profits jump.

Even McGee concedes, though, that CIT made downward "adjustments" to income totaling \$221.6 million last May, just before the deal closed. The result, disclosed in its 10-Q filed for the quarter ending June 30, is that CIT swung into the red in April and May, losing \$78.8 million. Then, in June, CIT earned \$71.2 million.

Several things look fishy about that \$150 million turnabout, Tice's Meyer maintains. To start with, in that April-May period, CIT took a massive \$148.1 million "provision for credit losses." That was well over twice the \$68.3 million provision CIT took in the entire first quarter. McGee says the spike occurred after Tyco called in "at least half a dozen" firms to scrub CIT's books and then decided to pull back from lending to troubled telecoms.

Tyco shakes up firms it acquires, he says, "and a non-recurring writedown is required when there is such a change in strategy." But the CEO of another major financial-services company says: "I would take this with a large grain of salt." CIT was "pretty well-run" he says. Meyer adds: "In effect, they're saying Gampier, whom they paid a big bonus to stick around, was turning a blind eye" to problem loans.

At the same time, CIT booked a \$54 million charge for acquisition-related costs. McGee claims they were incurred by CIT only and that under generally accepted accounting principles, "they must be recorded prior to the close of the acquisition." However, Jack Ciesielski, publisher of the *Accounting Observer*, notes that CIT also adopted "a new basis of accounting" on June 2, allowing Tyco to "push down" deal costs to CIT.

CIT'S INSTANT RECOVERY

CIT Group was solidly profitable before Tyco announced a buyout in March, 2001. But in the next two months, CIT swung sharply into the red—then came roaring back in June, after the deal closed and it was re-named Tyco Capital. Here's the story behind the turnabout:

Data: CIT Group Inc.

CIT

BEFORE THE TAKEOVER

- CIT's "other revenue" plunged to \$25.9 million in April and May
- Credit-loss provisions jumped to \$148.1 million in April and May
- CIT took a \$54 million charge for acquisition costs

TOTAL NET LOSS
\$78.8
MILLION

tyco

Capital

AFTER TYCO MOVED IN

- "Other revenue" rose to \$95.9 million in June
- Provision for credit losses dropped to \$18.6 million in June
- No charges were taken for acquisition costs

TOTAL NET INCOME
\$71.2
MILLION



TYCO'S KOZLOWSKI

An earnings jump raised suspicions

He adds that it was the result of a decision to write down "certain equity investments" in telecom and e-commerce—a decision supported by accounting rules. But Meyer argues the decision to book the charge against other revenue suggests that "all this might be in line with GAAP, but the rules allow for so much discretion that it becomes laughable."

Even if you accept Tyco's explanations for each of those items, the bottom-line impact is indisputable: The huge surge in charges taken by CIT just before the deal closed—combined with the drop in "other revenue"—helped produce a noticeable jump in CIT earnings just after the deal closed. In CIT was the major reason Tyco reported a 34% increase in per-share earnings for the quarter ending Sept. 30, just as profits were tanking throughout the rate America.

Those surprising results soon hit Tyco a magnet for critics looking for the next Enron. Those concerns

Kozlowski's plan to split up the company pushed Tyco's share price down to \$22 by May 5, just 37% of its price on Dec. 31. It then rebounded to about \$40 but took another hit on Feb. 13, when Tyco issued another earnings warning.

Thanks partly to a drawdown of liquidity, CIT has encountered difficulty in meeting its debt obligations due through June. But "having access to the commercial-paper market is a fundamental premise of the business," says Robert Young, a senior advisor at Moody's Investors Service. "If that access must be cut loose, Will Kozlowski

much for his once-prized asset? The preferred option is to sell CIT and use the cash to reduce Tyco's own debt, which was \$28.3 billion as of Dec. 31, according to S&P. Several potential buyers suggested by sources close to Tyco have already withdrawn, including GMAC, AIG, and UPS. That leaves GE as one of the few bidders. Some big banks and insurance companies, figures Paul Scura, managing director of Scura, Rise & Partners boutique investment bank. But any bidder is unlikely to pay full price for Tyco, especially since they know Tyco is on a tight timetable. Bannister expects Tyco to get no more than \$7.7 billion even though CIT is valued at \$11.1 billion on its books.

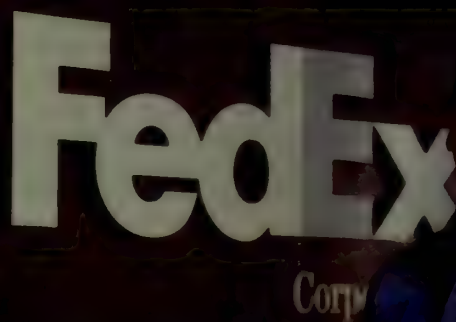
Kozlowski's other option is to offer most of CIT to Tyco shareholders. It might command a higher market value on its own than Tyco would get in a distress sale. Problem is, that would help Tyco raise cash anytime soon. Either way, a quick divorce is a fit end to Kozlowski's worst merger.

By William C. Symonds in Boston with Heather Timmons and David Brady in New York

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BANKRUPTCY

HOW TO LEAVE YOUR INVESTORS FUMING

Winnick's plan to sell Global Crossing raises more hackles

The problems are getting worse for Global Crossing Ltd., the former telecom highflier now in bankruptcy court. On Jan. 29, a whistleblower letter was made public with accusations that Global had inflated its revenues and profits through swaps of capacity on its fiber-optic network. An investigation by the Securities & Exchange Commission is in full swing (page 53).

Now, *BusinessWeek* has learned, shareholders are accusing founder and Chairman Gary Winnick of trying to sell Global Crossing to two Asian companies on the cheap in a deal that would allow management to keep an ongoing stake in the business. Under the terms of the restructuring plan, set out in a Feb. 7 SEC filing, Hutchison Whampoa Ltd. and Singapore Technologies Telemedia will buy 79% of the company for \$750 million. Creditors owed about \$12.4 billion would receive \$300 million in cash, \$800 million in new debt, and shares in the reorganized company.

And while existing shareholders would get zip, management could eventually get a 10% stake. "They will own 10% of a company with a clean balance sheet," complains Jay Province, a Web site designer in Charlottesville, Va., who owns 35,000 shares. "This is abuse of the bankruptcy courts." A spokesman for Winnick says: "It's up to the buyers to determine management's stake." The company declined comment.

Winnick, a former Drexel Burnham Lam-

bert Inc. bond salesman, has sold \$734 million worth of Global Crossing stock since the company went public four years ago. According to one former Global Crossing executive, two directors, Gannett Co. Chairman and CEO Douglas H. McCorkindale and Scientific-Atlanta Inc. Chairman and CEO James F. McDonald, said they left the company's board last year after they grew concerned about the high compensation packages of Winnick and other senior executives. McCorkindale and McDonald, who made up two of the three members of Global's compensation committee at the time, declined to comment. Winnick's spokesman says: "The two cited time pressure as the reason for their departures."

With unhappiness over Winnick's restructuring plan growing, a shareholder group plans to make a counterbid through a "rights" offering, which would allow existing investors to keep their stakes by putting more money into the company. The offer would also provide for a higher price than that of the current reorganization plan, say sources close to the deal.

The company says it will consider any offers. "Any final agreement would take place after additional negotiations and after approval by the court and all appropriate regulatory bodies," says company spokesman Daniel Coulter.

According to Chanin Capital Partners, which represents Global Crossing bondholders, the current offer values Global Crossing at just 11% of its property, plant, and equipment. Other companies, such as Level 3 Communications and Williams Communications Group, trade for between 30% and 50%. That implies a valuation as high as \$5 billion for Global Crossing, about five times more than the current offer.

Given that yawning gap, the fight for control of what's left of Global Crossing is just heating up.

By Christopher Palmeri in Los Angeles and Peter Elstrom in New York

ENRON & BEYOND



CARTWRIGHT:
THE CEO
SHRUGS
OFF AN
SEC PROBE

ENERGY

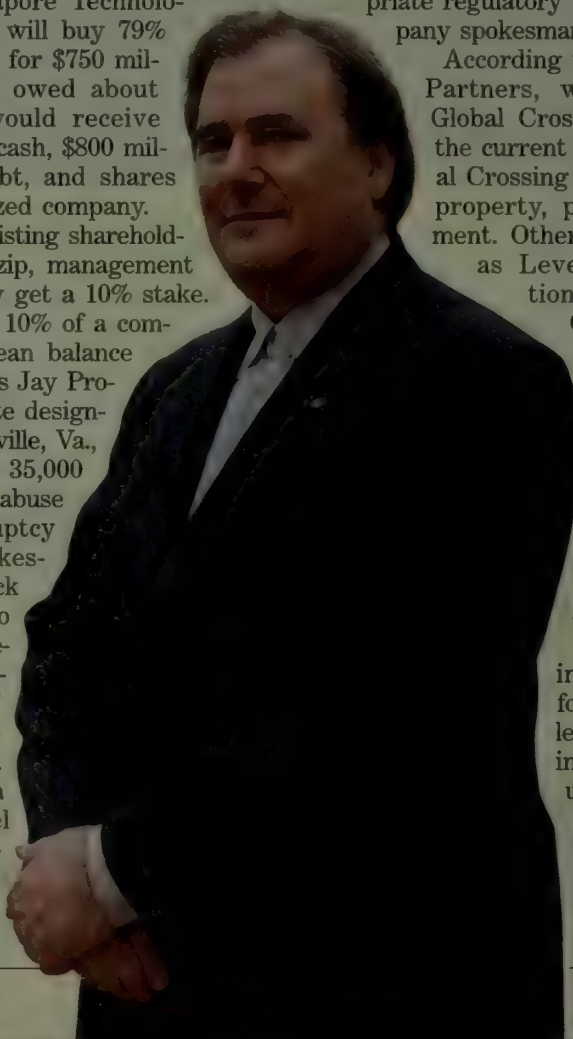
REAL ASSETS MAY NOT BE ENOUGH TO SAVE CALPINE

Analysts question its liquidity disclosure, and core strate

Until recently, Calpine Corp. was star of the power industry. Until Enron Corp., which mostly trades power, Calpine had real assets. It had ambitious plans to spend billions on new power plants to increase electricity output tenfold by 2005. Street expected huge gains in revenue and earnings. As deregulation took its shares more than tripled, to \$57 between January, 2000, and April, 2001.

Today, Calpine is powering down. In Enron's wake, investors are worried about the company's disclosure practices. It's reeling from falling electricity demand caused by the recession from the debts it racked up to build new plants. Calpine faces uncertainty about its liquidity and expansion strategy. "We're questioning its ability to stay financially viable until an economic recovery comes," says William D. Harris, an analyst at CIBC World Markets.

Adding to Calpine's woes is the Securities & Exchange Commission. On Feb. 6, the company revealed that the SEC was investigating whether it violated selective-disclosure rules by allegedly telling a few analysts about its building plans before announcing them publicly. And, in response to an order from the SEC, Calpine made disclosures on Feb. 13 about its payment arrangements with the now-bankrupt Enron derivatives transactions, and its contacts with the California state gov-



WINNICK:
Backlash

Sales in 1996 when

purchase order, account receivables,
and account payables were
processed manually:

twin

Then
someone had the
best
insight

Sales in 2001 when
databases are automated and
integrated after request
by nation's largest retailer:

king

Haywin Textiles makes comforters, bedspreads, and sheets. Not long ago, presumably after a night of deep sleep, their CFO decided to replace their manual accounting system with Best Software's MAS 200. Instantly, MAS 200 integrated the front office to the back office to shipping. Acting on a key customer's request, Haywin used a powerful MAS 200 module to electronically interface with the customer. Processing improved. Productivity went up. Which is what happens when someone gets a key insight into their business. Another comforting reason why more CPAs recommend Best than any other large-range business management software. For all the details, visit www.bestsoftware.com/haywin

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ment, a major customer. Despite the scrutiny, "there's no restatement of earnings," says Calpine CEO Peter Cartwright.

Nonetheless, investors have driven Calpine shares down 60%, to about \$8.50, since Enron filed for bankruptcy protection on Dec. 2. And Calpine clearly has other problems. It risks running out of cash if demand for power doesn't return. Lehman Brothers analyst Daniel Ford estimates the company's sources of cash for the year total \$4.4 billion, just a tad over its estimated \$4.3 billion in expenses.

The company contends that Ford's cash estimate is too low. It expects to generate about \$1.2 billion in operating cash flow in 2002. It also claims an additional \$1.8 billion in cash and bank credit lines totaling \$875 million and says it will build a surplus of "several hundred million dollars."

Even so, Calpine will certainly struggle to build that cushion. Its low stock price may rule out issuing equity, and the debt market doesn't look any more inviting. In December, credit-rating agencies Fitch and Moody's Investors Service downgraded \$12.7 billion of its debt to junk status. And an industry glut may make selling assets tough.

Nor can Calpine depend on strong growth. No one knows when the economy will recover and reignite power prices. Until that happens, Calpine's outlook remains grim. Many analysts think the company's projected net earnings of \$748 million this year, up 13.4% from a year ago, is too optimistic. UBS Warburg, for one, expects 2002 earnings to fall to \$594 million. Indeed, California is now seeking to renegotiate its big long-term contracts with Calpine at lower prices. "If California were to successfully renegotiate, servicing \$13 billion in debt becomes dicey," says Peter Navarro, a business professor at the University of California at Irvine.

To preserve cash, Calpine has halved its 2002 capital spending budget. The \$2.5 billion now earmarked for construction will be used to finish those plants already in progress. "When the economy returns to normal, we'll be in a strong position," says Cartwright. Still, rating agency Fitch figures Calpine shouldn't continue to build plants at all.

Calpine is surely not in the heap of trouble and scandal Enron now finds itself in. But unless it can shore up its balance sheet and make better sense of its aggressive build out, it too faces a dim future.

By Louise Lee in San Mateo, Calif., with Christopher Palmeri in Los Angeles

News: Analysis & Commentary

TOYS

WAR OF THE WHIRLS

Beyblade fighting tops are set to invade the U.S.

Each day, Kodai Saito longs for school to end so he can go back to banging his whirling Beyblades tops off the walls of his suburban Tokyo home. "My favorite toy," says the seven-year-old blader. That's an understatement: The first grader has painstakingly assembled 25 of the armored tops for combat against his friends' blades. "[It's] better than staring at a home video game for hours on end," says his mom, Junko, 35. "Plus, the toys are cheap."

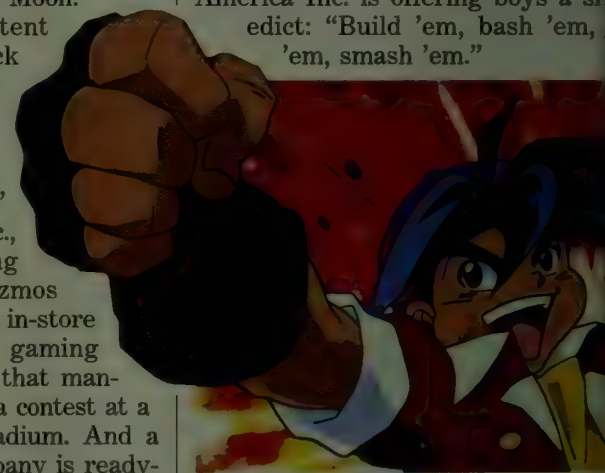
That twin appeal has created a juggernaut in Japan, where moms and their brood have been staging pre-dawn vigils at toy store entrances in order to snag the latest Beyblades delivery. No surprise, then, that manufacturer Takara Shuzo Co. is racing a pack of rivals to break into the huge U.S. market, a proven gold mine for a string of Japanese hits ranging from Power Rangers and Tamagotchi to Sailor Moon. With the once-omnipotent Pokémon doing a quick fade, toymakers everywhere want to fill the gaping opening for the next boys' toy bonanza.

That's where Beyblades' U.S. marketer, Hasbro Inc., comes in. It's now rolling out the multicolored gizmos with a blitz of TV ads and in-store stunts. It even plans a gaming league like one in Japan that managed to lure 6,500 kids to a contest at a Tokyo sumo-wrestling stadium. And a Canadian production company is readying a U.S. version of a Beyblades cartoon series that proved crucial in igniting the fad in Japan a year ago.

What's the appeal? Though named for simpler, 1960s-era spinners called *bey-goma*, the battling Beyblades are definitely not your father's top. Kids can snap together combinations of weight disks, weapon rings and other nefarious parts to create tops with the stamina or destructiveness to outlast rivals in battles waged in little plastic arenas. Adding to the appeal are Pokémon-like "spirits" that impart special

powers. At \$7, Beyblades seem expensive. But the highly collectible gets, together with all the launch arenas, and other gear a seven-year heart can desire, have the potential to put a family hundreds of dollars in the hole by the time the fad is over.

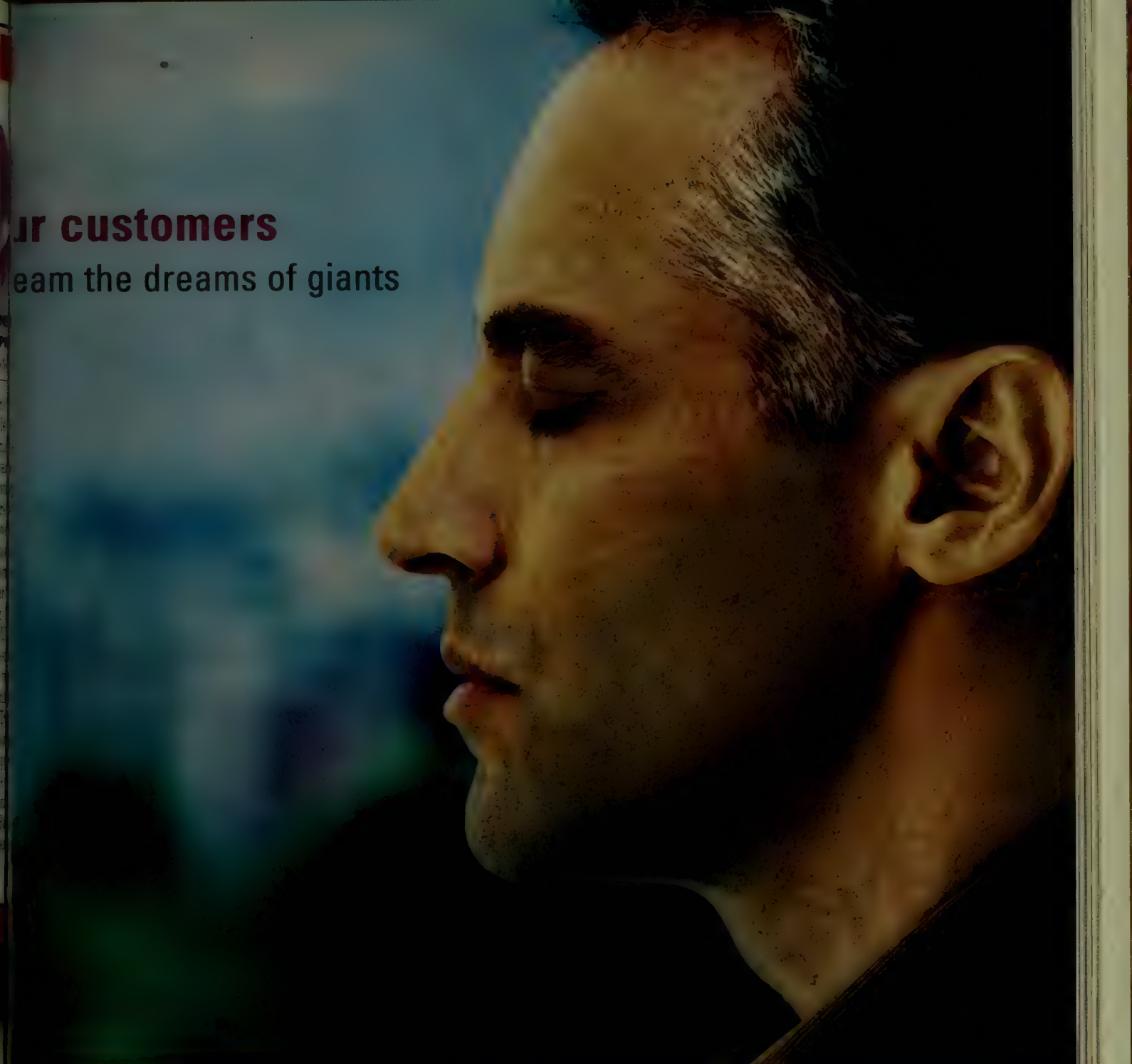
None of which has gone unnoticed by other toymakers, many of whom are working furiously to ready their battling tops. "Not everything Japan has done well in the U.S.," warns Amy L. Weltman, vice-president of marketing for ToyMax Inc., who nevertheless will trot out light-emitting tops called Spinjas this summer. Takara master Inc. is extending its popularity by adding Rumble Robots into Rumble Rippers with a gyroscope that enables the user to take a licking and keep on spinning. And for its Cyclonians Eggbots, Bandai America Inc. is offering boys a sidekick edict: "Build 'em, bash 'em, beat 'em, smash 'em."



BEY WATCH: A hit on Japanese TV

Will the vicious Eggbots beat out more elaborate Beyblades? "No comparison," says Michael Riley, Bandai vice-president of marketing. "We're definitely kick their butt." Ouch! Count on Samantha Lomow, Hasbro's vice-president of boys' toys marketing: "We're the authentic brand." So there, Eggbots. Looks like a rock 'em, sock 'em battle is brewing in Toyland.

By Gerry Khermouch in New York with Chester Dawson in Tokyo



Our customers
dream the dreams of giants

They dream of a world without disease. They dream of a wireless world where information flows effortlessly. Where cutting-edge electronics work flawlessly. These are not the dreams of the timid. They are the dreams of giants. And Agilent is providing technologies to help make them a reality faster than ever. Here's to the dreamers. And the world they see with their eyes closed.



Agilent Technologies

dreams made real

EDITED BY MONICA ROMAN

EXONERATING THE EXPLORER

IT'S THE FIRST GOOD NEWS in a long time for Ford Motor. On Feb. 12, federal regulators said they would not be launching an official investigation into the safety of Ford's Explorer sport-utility vehicle. Bridgestone/Firestone executives had demanded the probe, alleging that Explorer design defects had contributed to 271 deaths from rollovers of Firestone-equipped Explorers. But after what the National Highway Traffic Safety Administration called "extensive analysis"—including studying data supplied by Firestone—the agency took a pass. The NHTSA declared that it found Explorers were no more likely than comparable SUVs to crash after a tire tread separated. Ford still faces numerous lawsuits from accident victims and their families. The carmaker can only hope the news gives a shot in the

arm to flagging Explorer sales, which fell 7% last year.

LOUD TRUMPETS FOR VISUAL STUDIO.NET

WITH ALL THE FANFARE OF its earlier rollouts of Windows XP and the Xbox, Microsoft launched its Visual Studio.NET software on Feb. 13. The hoopla may seem odd for what amounts to a geeky set of software-writing tools. Visual Studio.net, however, is the cornerstone of Microsoft's plans to extend its PC dominance to the Web, taking on Sun Microsystems' popular Java programming language. The software gives developers the tools to write programs that run not just on PCs but also on the Web—a linchpin in Microsoft's Internet strategy. That's why it spent 3½ years and \$800 million developing the software. The trick for Microsoft will be getting its legions of developers—most of whom write low-margin software for PCs—up to Net speed.

CLOSING BELL

MORE WITH LESS

Office Depot's shares climbed 14.2% on Feb. 13, to 18.49, after it reported net income of \$58.1 million in the fourth quarter, vs. \$19 million in the year-earlier period. The office-supplies giant boosted profits, despite an 8% sales decline, by keeping a lid on expenses and closing some struggling U.S. stores.



LABOR SKIES MAY CLEAR AT UNITED

UNITED AIRLINES' UNIONIZED mechanics voted down a 37% pay hike on Feb. 12, opening the door to a possible walk-out. The 13,000 mechanics, who haven't had a raise since 1994, are angry at management. Still, the gap between the two sides is small, so the odds favor a settlement before the Feb. 20 strike date. At the same time, all of United's labor groups are talking to the company about swallowing concessions of up to 10% as part of a broad recovery program for the troubled carrier, which lost \$1.8 billion last year. United hopes to slash more than \$2 billion in costs. It also plans to borrow up to \$3 billion and restructure \$800 million in debt coming due this year.

HEADLINER: PETER DOLAN

ANYONE GOT A TRANQUILIZER?

THE HEAT IS ON BRISTOL-Myers Squibb CEO Peter Dolan. On Feb. 12, Bristol backed off its earlier ultimatum to biotech partner ImClone Systems to rework the terms of the two companies' co-marketing agreement for the cancer drug Erbitux.



In the wake of the Food & Drug Administration's refusal to consider the product's application, the 46-year-old Dolan had demanded more control over the drug and a reduction of the payments Bristol would have to make to ImClone. But ImClone's board balked. And while sources close to the talks

said Bristol was prepared to walk, Dolan now says the company will wait until a Feb. 26 meeting with the FDA to make a decision. Dolan has been criticized for overpaying for rights to the ImClone drug last fall when Bristol agreed to buy \$1 billion in ImClone stock and pay an additional \$1 billion as the drug moved toward approval. And that's not his only problem. At the same time Bristol's growth will slow generic competition hurts diabetes drug Glucophage and cancer drug Taxol and the near-term pipeline remains weak.

Amy Barr

DUPONT REMOVES ITS NYLONS

DUPONT IS SLIMMING DOWN. On Feb. 12, the chemicals giant announced it would create a separate unit for its \$6.5 billion fibers business, which includes nylon and polyester, with plans for a possible spin-off by the end of 2003. Analysts have said for years that the Wilmington (Del.) company should sell the cyclical, slow-growing operation. The move is part of DuPont Chairman and CEO Charles Holliday Jr.'s efforts to produce reliable double-digit earnings growth.

BACKPEDALING AT MOODY'S

MOODY'S INVESTORS SERVICE has scaled back a plan to overhaul the way it rates credit. In response to criticism that ratings services are often late to alert investors

that a company is heading toward bankruptcy, Moody's proposed using market prices and a shorter time frame in its analysis. But Moody's clients objected, fearful market volatility would affect ratings. Clients fret that lower downgrades will result in companies being cut off from credit and force frequent changes in portfolios linked to holding investment-grade bonds. Moody's now plans to stick with a long-term view but to keep a closer watch on accounting, disclosure, and balance-sheet obligations.

ET CETERA...

- The SEC plans to make companies file quarterly and annual reports more promptly.
- Nine states have asked a judge to force Microsoft to reveal the Windows source code.
- Walgreen's has new policies to avert teen smoking as part of a pact with 40 states.

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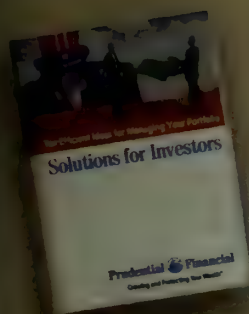
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EDITED BY RICHARD S. DUNHAM

GLOBAL CROSSING: WHERE'S THE OUTRAGE ON CAPITOL HILL?

As scandals go, the collapse of Global Crossing has plenty of juice. Like Enron Corp., Global Crossing Ltd. sold itself as a high-flying corporate pioneer. Laden with debt, Global engaged in creative accounting that inflated its value—to much as \$48 billion. It used the same auditing firm, Arthur Andersen. A similar freeze on Global's employee 401(k) plan effectively prevented workers from selling company stock. And, like Enron, Global Crossing used lavish political gifts to cultivate an array of influential friends that included a national party chairman, a President, and a former President.

Given the remarkable similarities, why isn't Congress paying more attention to Global Crossing? To date, no committee has scheduled hearings or launched a formal inquiry—neither the Securities & Exchange Commission nor the FBI open their own investigations. Conservative activists complain that media bias against Republicans has kept Enron's political web in the spotlight while Global Crossing's influence peddling remains in the shadows. But there's no shortage of daily questions about the telecom startup's questionable practices and political ties.

The real reasons Global Crossing isn't under the microscope on Capitol Hill—have to do with the careful political calculus of both Democrats and Republicans. Dems, of course, have no interest in turning up the heat on a company that wrote them fat checks and put party fund-raisers on the payroll. A recently released tally by the nonpartisan Center for Responsive Politics found that Global Crossing gave \$3.6 million to candidates of both parties since 1997, 55% of it to Democrats. The real embarrassment, however, is Democratic National Committee Chairman Terrence McAuliffe's \$100,000 investment in 1997, when Global Crossing founder and Chairman Ken Winnick was launching his telecom upstart. McAuliffe, a

onetime consultant to Winnick and close friend of then-President Bill Clinton, reaped perhaps as much as \$18 million when he cashed out most of his holdings in '98 and '99. McAuliffe set up golfing dates with the Prez for his pal Winnick, who pledged \$1 million to Clinton's Presidential library. "This wasn't a sweetheart deal," says DNC spokeswoman Jennifer Palmieri. "McAuliffe was a stockholder, as was former President Bush."

Therein lies a key GOP reason for treating Global gingerly. The senior Bush gave a speech on the company's behalf in Tokyo in 1998 and took stock in lieu of \$80,000 for his fee. "There is a feeling that this is like grenades at close quarters—

everyone can get hurt," says Ken Boehm, chairman of the National Legal & Policy Center, a conservative watchdog group.

Enron overload is partly to blame for congressional inaction. House Energy & Commerce Committee Chairman W.J. "Billy" Tauzin (R-La.), whose panel oversees telecom, has held seven Enron-related hearings in three weeks. Republicans also worry that there may be little political gain from delving into charges of favors for Global Crossing if such payoffs can't be proved. Dems, they scoff, aren't getting much traction out of allegations that the GOP did Enron's bidding.

It's too early to write off a major congressional inquiry into Global Crossing. The SEC and FBI may yet turn up wrongdoing that lawmakers can't ignore. GOP operatives are quietly researching Democrats' ties to Global in hopes of finding a political smoking gun. One target: U.S. Senate candidate, Tom Strickland of Colorado, who lobbied for Global. Judicial Watch, a right-wing group that went after the Clintons, will soon pore over reams of government documents that could uncover favors done for Global Crossing. But for now, partisans are leery of digging too deeply lest they get themselves dirty.

By Amy Borrus, with Lorraine Woellert



DEMS' McAULIFFE: Early stockholder

CAPITAL WRAPUP

ENRON AND THE CLINTONITES

Republicans may be holding their fire in the Global Crossing debacle, but they're rolling out the heavy artillery in the Enron scandal. Top GOP operatives, smarting from allegations that the Bushies did favors for Enron Corp., have uncovered more than a dozen examples of financial goodies the Clinton Administration gave Enron.

Senate Finance Committee documents indicate Enron got more than \$500 million in loans and other backing for international projects from the

U.S. Export-Import Bank in 1993-2000. That's just some of the Clinton-era support of Enron, which showered soft money on both parties. "People think getting calls returned from the Bush Administration is the only help Enron got," says a staffer to Senator Charles E. Grassley (R-Iowa), the committee's ranking Republican.

While Clintonites regularly went to bat for U.S. companies competing around the world, Enron seems to have done better than most. Enron executives took part in at least 11 trade missions with the late Commerce Secre-

tary Ron Brown and Trade & Development Agency officials.

Republicans are scouring Enron's payroll for Clintonites who hired on there. Among them is Linda L. Robertson, a top deputy to former Treasury Secretary Robert E. Rubin. Robertson was later hired as an Enron lobbyist in Washington. Rubin, now chairman of Citigroup's Executive Committee, drew criticism for a call he made to Treasury last fall wondering if anything could be done to save the credit rating of Enron, a major client of Citi.

By Amy Borrus

GOVERNMENT

POWER SHIFT

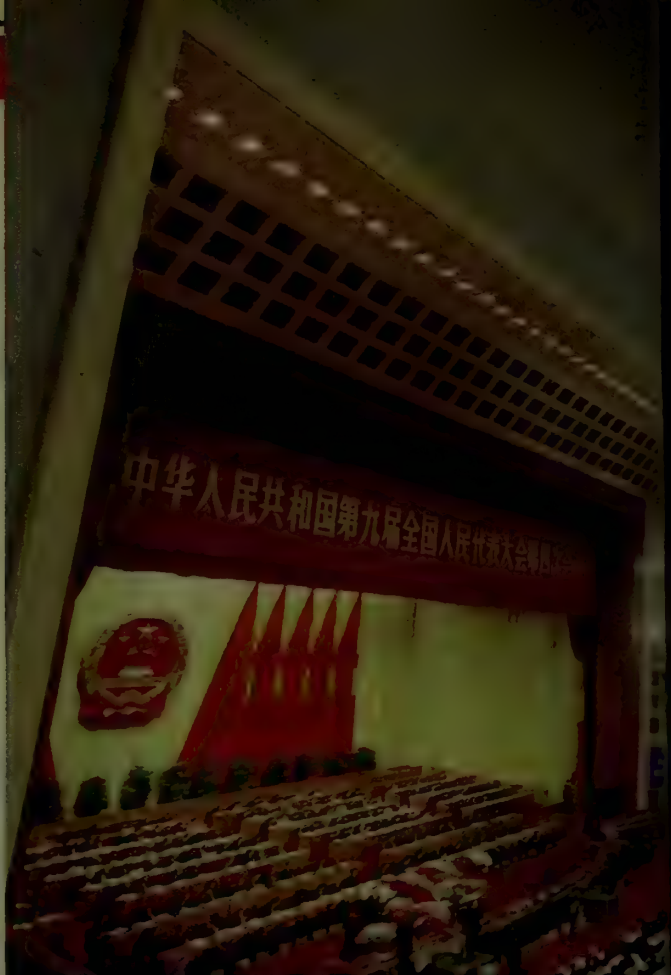
China gets set for new leaders

For a man first in line to be the next President of China, Hu Jintao is a conspicuously enigmatic figure. Currently China's Vice-President, Hu, 59, rarely travels overseas and even at home remains something of a mystery. No wonder aides to President George W. Bush have been trying for some time to bring the two men together. Bush may finally get his chance when he makes his first state visit to Beijing on Feb. 21-22.

Taking Hu's measure is crucial because his expected ascension next year will be part of the most extensive government overhaul in recent Chinese history. Fully half of China's top government officials are expected to retire in coming months, making way for the so-called fourth generation of leaders. The first generation was led by Mao Zedong, the second by Deng Xiaoping, and the third by current President Jiang Zemin. Besides Hu, the fourth generation includes current Vice-Premier Wen Jia-

obao, 59, who is slated to become Premier, and Zeng Qinghong, 62, a senior Communist Party official who could become Vice-President. At the same time, the chairmanship of the National People's Congress, China's parliament, may go to a liberal from the third generation named Li Ruihuan. If history is any guide, these men could be at the helm of the world's fastest-growing economy for the next 5 to 10 years.

How far will Hu, Wen, and the others move China from its thoroughly authoritarian but increasingly free-market path? Will democracy be allowed to spread beyond the village level? Will the brutal campaigns against dissidents, criminals, and religious and ethnic minorities be moderated? Will the issue of corruption—including wrongdoing attributed to the princelings, or sons and daughters of the elite—be frankly addressed?



GROWING FORCE: The National People's Congress is

While the successors of President Jiang Zemin and Premier Zhu Rongji are expected to push ahead with economic reform, sorting out the rest of the agenda of the new generation is no easy task. These leaders, long ministers, may at any moment, shun the spotlight and keep contact with foreigners to a minimum. China-watchers agree, however, that the next crop of leaders will jettison ideology for pragmatism—notwithstanding the occasional rhetorical blip.

Mostly in their 50s and 60s, they are too young to have taken part in the Communist revolution that helped end the rigid views of their predecessors. Rather, this generation came of age during destructive political campaigns

INSIDE TRACK



LUO GAN

A hard-line ally of Li Peng, Luo is in charge of the "Strike Hard" anti-crime campaign. The 66-year-old Shandong native studied engineering in East Germany, where he

lived from 1954 to 1962. Luo was made a State Councillor in 1993 and appointed to the Politburo in 1997.



ZENG QINGHONG

The 62-year-old graduate of the Beijing Engineering Institute is a key Jiang Zemin ally; detractors call him a sycophant. He runs the Communist Party's Organization Dept., which

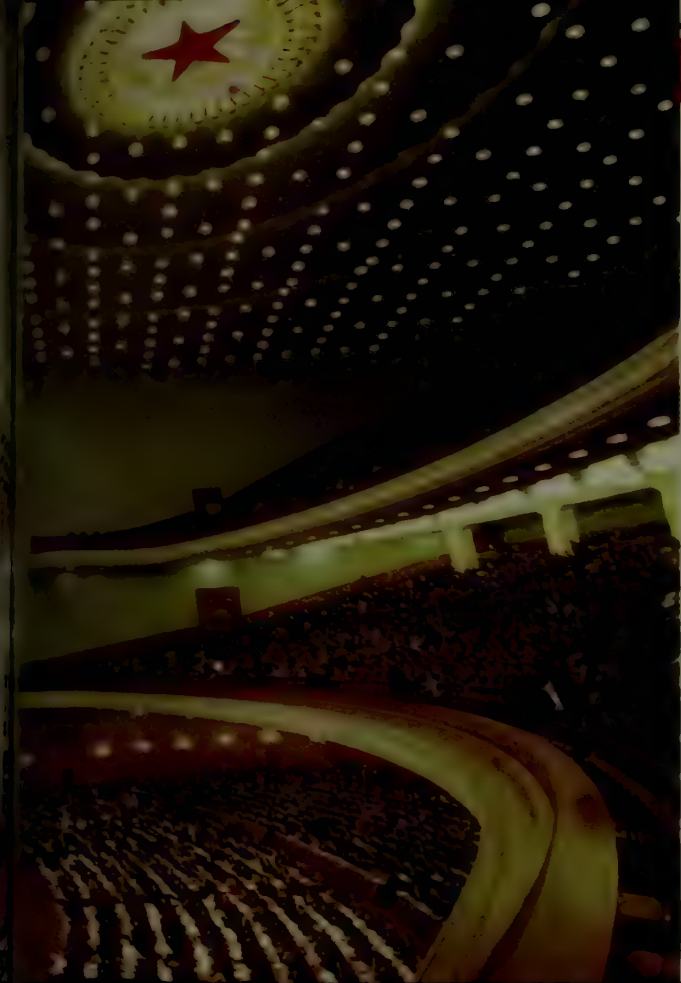
is responsible for personnel matters. Jiang failed three times to make him a full member of the Politburo.



LI RUIHUAN

Formerly a liberal, Li is a key figure in the National People's Congress. He is expected to become its chairman.

Portsmouth, N.H., is expected to succeed Li Peng as President of the National People's Congress.



rubber-stamp image by voting against government policy

the Great Leap Forward and the Cultural Revolution. Hence, they distrust dogma and know how to keep their heads down and their mouths shut. In a China where it is no longer possible to be a patriarch in the mold of Deng Xiaoping or Mao Zedong, Hu & Co. are expected to forge policy through consensus. In recent years, various initiatives have gathered increasing power, forcing the central government and the Communist Party to become more accountable and flexible. One growing force is the National People's Congress. While it still acts like a rubber-stamp parliament much of the time, the NPC has been voting against government policy in recent years. The media, too, have become bolder: While still tightly cir-

cumscribed, they regularly report on official malfeasance. At the same time, the public is becoming increasingly vocal on everything from official corruption to rural reform.

China has also become too decentralized and complicated to be run by remote control from Beijing. The nation's gross domestic product has quintupled, to \$1.19 trillion, since 1990, and by most accounts could outpace Japan to become the world's second-largest economy by 2030. Much of that growth has been generated by tens of thousands of new private and quasi-private enterprises that can't, or won't, be tightly

controlled from the top. The new leaders must continue the delicate process of dismantling thousands of useless state enterprises and finding work for millions of displaced workers. And of course, now that China is a member of the World Trade Organization, Hu & Co. will be forced to abide by its strictures—some of which will be deeply painful to society.

Given the extraordinary challenges they face, it is fortunate that the fourth generation is one of the best-educated group of leaders in Chinese history. Unlike their predecessors, many of whom were force-fed a narrow Soviet curriculum, Hu and his contemporaries are open to a range of ideas. During a trip to Europe last year, Hu displayed an

unusual willingness to listen to his aides. "It was completely different from how Jiang or Zhu deals with their staff," says a Western diplomat. On the same trip, Hu demonstrated a keen interest in world affairs.

Clearly, continued market liberalization will be a priority. Wen's reformist credentials are strong. He spent the past five years heading up reforms in two of China's most difficult areas: the corrupt financial sector and the lagging rural economy. Under Wen, Beijing has adopted policies aimed at reversing the growing urban-rural prosperity gap, including an effort to ease the tax burden on rural residents. "[Wen] is concerned with the low income levels of the peasants," says a political scientist in Beijing.

China's next leaders will no doubt continue the policy of gradually extending Beijing's influence over the rest of Asia. At the same time, they will likely foster better ties with the U.S. China's new technocrats understand how much their nation relies on the U.S. for everything from technology and investment to education visas for the country's many overseas students.

To be sure, there are still irritants—not the least of which is Washington's support for Taiwan and its plans to shield the island from any mainland missile attack. These issues will be on the table when Bush visits Beijing, as will America's increased presence in the region. Yet even on Taiwan, the new generation may be more flexible. Already there are signs

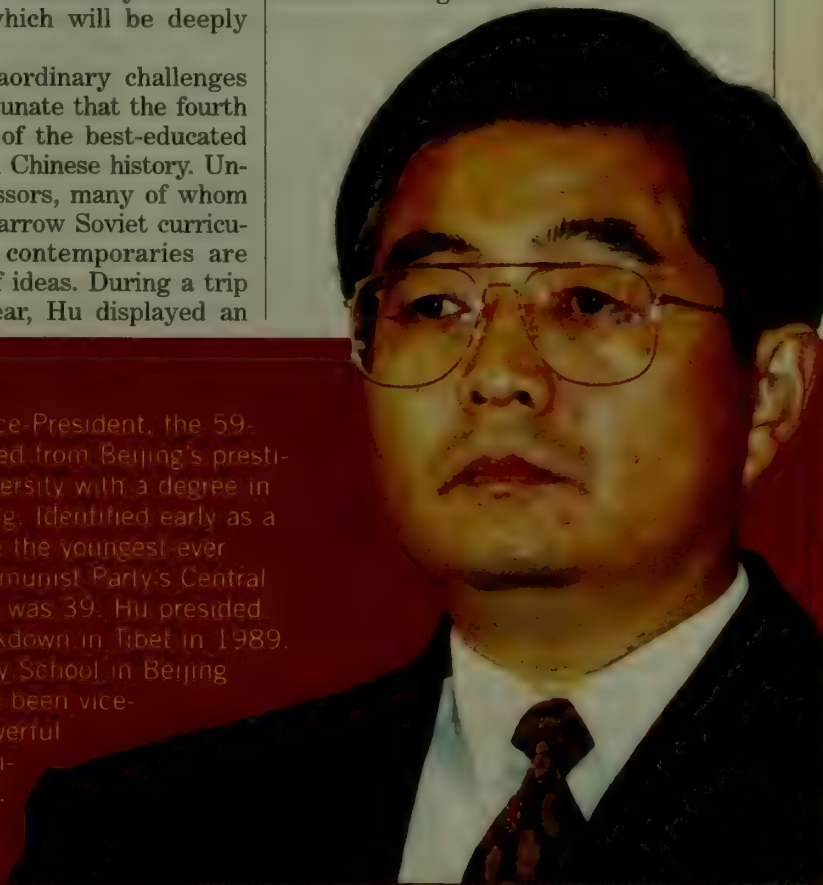


WEN JIABAO

The 59-year-old Vice Premier has the most impressive track record of his generation, thanks to his work in agricultural reform. He also oversees the cleanup of the battered financial system. Still, critics say, his eagerness to please makes him afraid to take tough decisions.

HU JINTAO

Currently China's Vice President, the 59-year-old Hu graduated from Beijing's prestigious Tsinghua University with a degree in hydraulic engineering. Identified early as a high flier, he became the youngest-ever member of the Communist Party's Central Committee when he was 39. Hu presided over a ruthless crackdown in Tibet in 1989. He has run the Party School in Beijing since 1993 and has been vice-chairman of the powerful Central Military Commission since 1999.



China's technocrats understand how much it relies on the U.S. for everything from technology to student visas

that Beijing's approach could soften. When Vice-Premier Qian Qichen gave a speech that appeared to offer a much more conciliatory approach toward Taiwan last month, both Hu and Zeng were present—a fact featured prominently in news reports.

One factor that will contribute to a peaceful resolution of the Taiwan issue is the waning influence of the People's Liberation Army. Its last representatives were bumped from the powerful standing committee of the Politburo of the Communist Party in 1997, and since Jiang became President, the generals have been largely forced out of their once-extensive business operations. Says a Western diplomat in Beijing: "The political stock of the [PLA] has fallen."

There are even signs that Hu & Co. will speed up political reform. Public unhappiness over corruption and the lack of accountability of local officials could explode, and Hu and his comrades

know they must find a way to defuse this anger. Protests by agitated citizens have become a daily occurrence across China. Political reform "is the essential step to maintain political stability," says Feng Chongyi, a professor at the University of Technology in Sydney.

How might political reform look under Hu? As head of the Central Party School, the training ground for cadres and party leaders, he has allowed research into which political systems best suit China. On a trip to Europe last year, Hu expressed keen interest in the structure of Germany's Social Democratic Party. And at a January conference in Beijing, critics of the Communist Party openly called for more rapid democratization, says Feng, who attended. "It is quite astonishing," he says. "Even high-ranking officials spoke candidly." That said, there's a huge difference between discussion and implementation.

To be sure, there are potential pitfalls ahead for the new leaders, most notably their lack of policymaking experience. Under China's top-down au-

thoritarian system, midlevel officials often find themselves carrying out orders from above rather than risking their necks by formulating innovative policies. "If one wants to become a cadre, they must toe the line," says Li Shenzhi, a former adviser to Zhou Enlai and one of the present Chinese leadership's most vocal critics. Most of them "are younger officials who are probably more

sarily triumph in China. Despite cent signs of political reform, the leaders likely will favor a one-party state for the foreseeable future. tionalism could derail efforts to improve relations with the U.S. Indeed, Hu tao already has experience manipulating China's patriotic youth: After the strike of Beijing erupted with protests following the U.S. bombing of the Chi-

embassy in Belgrade in May, 1999, Hu was the leader who first appeared on television to appeal for calm. But the future President also had to give words for the U.S. He expressed strong support for the Chinese students.

Moreover, the new generation of leaders is as capable of ruthless behavior as its predecessors. Luo Gan is held responsible by groups such as Human Rights Watch for widespread abuses, including the violent crackdown on the Falun Gong spiritual group. And in last year's Six-Party Hard campaign against crime, Luo over-



BEIJING PROTEST: Ordinary Chinese are increasingly vocal

liberal, but they dare not say anything."

That could leave an opening for older, more experienced hands. If Jiang and hard-line National People's Congress Chairman Li Peng have their way, they will follow Chinese tradition and continue to exercise power even if they hold few leadership titles. Jiang wants to stay on as chairman of the Central Military Commission—just as his predecessor Deng Xiaoping did after giving up his other leadership positions. Barring that, Jiang hopes his protégé Zeng will help ensure that his policies are followed.

For his part, Li Peng is intent on seeing his man Luo Gan, currently China's top law-and-order official, named head of the party's discipline body, which is in charge of the battle against corruption. That move would protect a host of retiring officials, including Li himself, who bears heavy responsibility for the bloody massacre in Tiananmen Square in 1989.

Some analysts say that growing tolerance and Westernization won't neces-

sarily lead to thousands of executions. Hu Jintao, however, has shown his willingness to crack hard when Beijing's ultimate authority is challenged. In early 1989, during his four-year tour as party secretary in Tibet, Hu responded to independence protests by instituting martial law. Scores of Tibetan demonstrators were shot and killed, and hundreds more were jailed.

How the next decade plays out depends largely on the ability of Hu and his administration to channel the forces unleashed in recent years by economic and political liberalization. Keeping a lid on social unrest, as always, will remain a top priority in Beijing. But if the fourth generation manages to keep corruption in check, maintain robust economic growth, and get more wealth flowing to the countryside, Hu & Co. may yet have the courage to take political reform to the next level and make China the great world power that it badly wants to be.

*By Dexter Roberts in Beijing,
Mark L. Clifford in Hong Kong*



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DEBT RATINGS

IN EUROPE, THE SEARCH IS ON FOR OTHER ENRONS

Investor pressure may force a huge telecom write-off

Is there an Enron Corp. in Europe's future? That's what investors in European equities and bonds are desperate to know—whether some off-balance-sheet bomb will soon go off at one of the Continent's blue chips. So far, hordes of analysts, investors, and short-sellers have failed to come up with a European horror story on the scale of the Houston energy trader.

Make no mistake, though: Enronitis is having its effect. Investors don't want any nasty surprises. They want clean balance sheets and lower debt—and they want all the bad news out in the open. Companies are responding. The biggest potential move: Analysts and consultants expect some of Europe's biggest telcos to write down up to 90% of the value of their investments in third-generation wireless phone licenses. Such a massive write-down would be one of the biggest balance-sheet cleanups in European business. The sheer size of the operation could still shake investor confidence.

A 3G write-down is not the only post-Enron drama unfolding in Europe. "Accounting issues and bankruptcy concerns

are dominating the markets," says Richard G. Davidson, equity strategist at Morgan Stanley Dean Witter & Co. in London. Companies as varied as Vivendi, ABB, and Pearson are getting the once-over from investors.

But the telcos seem to have the most to answer for. The companies that spent \$116 billion on European 3G licenses can no longer carry those assets on their books at full value because they're simply not worth it. One telco, KPN, confirms a write-down is in the offing, while analysts expect others to follow, including Vodafone. After all, in Germany, Italy, and Britain, where prices went through the roof, carriers paid some \$441 per capita for the right to offer 3G services, almost seven times the global average. The telcos "have tried pulling a rug over the hole in their book equity, but everyone knows it's there," says Rick Deutsch, head of credit

they're launched.

Even with 3G costs properly counted for, Europe's telcos will have to endure more post-Enron scrutiny. David E. Marcus, managing partner of Marcstone Capital Management, a New York-based hedge fund, says he's shying away from Deutsche Telekom because he doubts it can raise enough from asset sales to fulfill its pledge to cut its debt to \$43.5 billion, from \$57 billion. "They are not going to be able to get the values they need to get [from the sales]," says Marcus.

France Télécom has spooked investors not only with its estimated \$11 billion debt but with off-balance-sheet commitments. After the company took a 25% stake in cable operator NTL Inc., it struck a deal with some banks that financed NTL's acquisition of a Swiss cable company. The banks got shares in NTL with an option to sell them back to France Télécom later for a guaranteed \$1.1 billion. NTL now is in trouble and its shares are nearly worthless, but France

Télécom is still on the hook for the \$1.1 billion payment, due in March 2003. Although France Télécom notified regulators of the arrangement at the time, investors are focusing anew on the risks involved in such commitments.

It's not only overoptimistic dealmaking that investors want to see addressed. Engineering

Big Spenders

Amounts paid for 3G licenses in Europe

	WILLIONS
VODAFONE	\$19.4
BT/MMO2	14.1
DEUTSCHE TELEKOM	14.1
FRANCE TELECOM	12.1
KPN	10.0

Data: Yankee Group Research Inc.



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ABB Ltd. is trying to clean the slate \$1.4 billion in charges to cover asbestos liabilities and other items. Board members at the Swiss engineering giant are even pressing revered Chairman and CEO Percy Albrecht to pay back some of his \$80 million in severance benefits.

Europe's CEOs are definitely rattled by the turn of events, especially the pressure to deleverage. "There has been a completely brutal change from where it was practically ignored to a [point] where everybody is looking at how much money companies have," says Serge Tchou, chairman and CEO of French telecom equipment maker Alcatel.

The effect of the focus on leverage and the preservation of a company's debt structure is of paramount importance. In the case of British media company Pearson PLC. On Christmas Eve, the company suddenly accepted a cash offer of \$1.3 billion from Bertelsmann for its stake in Europe's largest broadcaster, RTL Group—about half what the company would have fetched in May. "We were amazed they accepted Bertelsmann's price," says a source close to the deal. Pearson won't publicly admit the deal was being twisted. But it is known that the company was going through a tough review by rating agencies Moody's Investors Service and Standard & Poor's and was at risk of a downgrade.

Other media companies are feeling the heat. Rival Vivendi Universal is being punished by investors nervous about its acquisition hunger and complicated structure. Its debt rose more than 20% in the past year, to an estimated \$26 billion, as Vivendi snapped everything from television group Canal Networks to publisher Houghton Mifflin. Another worry is the difficulty of generating cash flow. When Vivendi issued quarterly operating results last year, it booked 100% of the operating profits generated by Cegetel—even though Vivendi owns only 44% of the fast-growing French phone company. Vivendi will strip out the 56% it doesn't own when it releases net earnings on Mar. 1. "We are not saying there are accounting irregularities," says Michael C. Thanson, an analyst at Sanford C. Bernstein & Co. in New York. "But there is still a question: What is the earnings power of this company?" That's the question investors are asking about many European blue chips in the New Age of Scrutiny.

By Stanley Reed with Kerry Capell in London, Andy Reinhardt and Carol Attlack in Paris, and bureau reports

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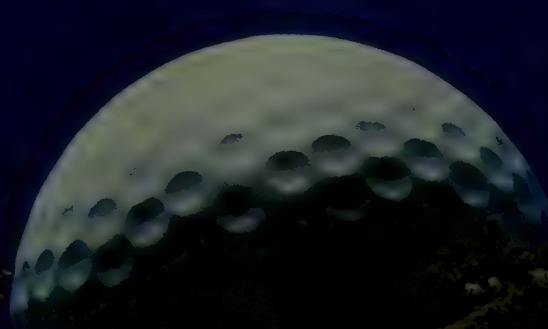
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EDITED BY ROSE BRADY

VENEZUELA: HOW LONG CAN CHAVEZ STAND THE HEAT?

"Chávez out!" That cry is growing louder by the day in Venezuela, where citizens are taking to the streets to protest against President Hugo Chávez. The former aviator has seen his approval rating plunge from 80% in 1993 to 24% today, as citizens have grown dissatisfied with his inability to improve their living standards. Even some in the military are giving Chávez a thumbs-down. On Feb. 6, Air Force Colonel Pedro Soto and National Guard Captain Pedro Flores marched with protesters to Chávez' home and called on him to resign. A military commission is deciding whether to discharge the officers.

Chávez is feeling the heat. Indeed, in a speech to the nation on Feb. 12, he offered an olive branch to his critics. "The opposition has to be constructive. I'm ready to revise whatever there is to revise," he vowed. Chávez also took a drastic step to curb capital flight and slash Venezuela's yawning budget deficit by allowing the currency, the bolívar, to float freely. The bolívar's value against the dollar plunged 20% on Feb. 13.

But even these steps are unlikely to prevent Venezuela, the world's No. 4 oil exporter and the No. 3 U.S. oil supplier, from escaping a period of political instability. The emboldened opposition is openly discussing ways to oust the President. Most experts rule out a coup, even though Soto claims most of the armed forces agree that Chávez should resign. Indeed, opposition leaders and political experts believe that the military would back a constitutional effort to force Chávez out. Initial moves against the President are under way. In early February, the opposition Democratic Action Party filed a petition with the Supreme Court challenging Chávez' mental competence. That's taking a page from Ecuador's book, where in 1997, Congress ousted President Abdalá Bucaram on grounds of insanity. Opposition members say they are col-

lecting psychiatric evaluations of Chávez, who is known for mood swings. The opposition may also charge Chávez with misusing defense funds for social projects, such as employing troops to sell subsidized food. Such an approach worked in 1994, when Venezuela's Congress impeached President Carlos Andrés Pérez for misuse of funds. Since Chávez' Fifth Republic Movement leads the National Assembly by just one vote, the opposition sees a chance to impeach him. Opposition strategists also think moderate Supreme Court justices will withdraw support from Chávez as protests mount. The court has yet to rule on the insanity motion.



PROTESTING: As the slump worsens

Meanwhile, the business community is lining up against Chávez. Business is appalled by a package of 49 economic laws that Chávez imposed by decree in November. They vastly increase state intervention in industries such as oil and fishing. To show their dismay, 80% of Venezuela's businesses shut down for a one-day "civic strike" on Dec. 10. "We don't like playing the role of the political opposition, but we're fighting for our very existence," says Luis H. Ball, president of medical-supplies maker Eurociencia and former president of industrial association

Conindustria. Key figures in the Roman Catholic Church, trade unions, and media may also back an effort to topple Chávez, who has blasted them with vitriolic rhetoric.

If Chávez goes, who will take over? One suggestion in Caracas political circles is to have a civilian junta made up of representatives of business, labor, and opposition parties rule until new elections can be held. Among those likely to contest the presidency would be Caracas Mayor Alfredo Peña and National Assembly Deputy Julio Borges, both center-right leaders. But Chávez won't step down without a fight. Venezuelans are bracing for a turbulent year.

By Christina Hoag in Caracas

GLOBAL WRAPUP

BRITISH AIRWAYS RETRENCHES

British Airways continues to shrink. On Feb. 13, Chief Executive Rod Eddington said the flag carrier would slash 5,800 employees, bringing the total layoffs since September 11 to 13,000—nearly a quarter of the former workforce. It will also cease operating 10 routes and curtail its use of Gatwick Airport, south of London. But analysts doubt that the moves are radical enough to return the company to strong profitability. BA is expected to lose approximately \$700 million for

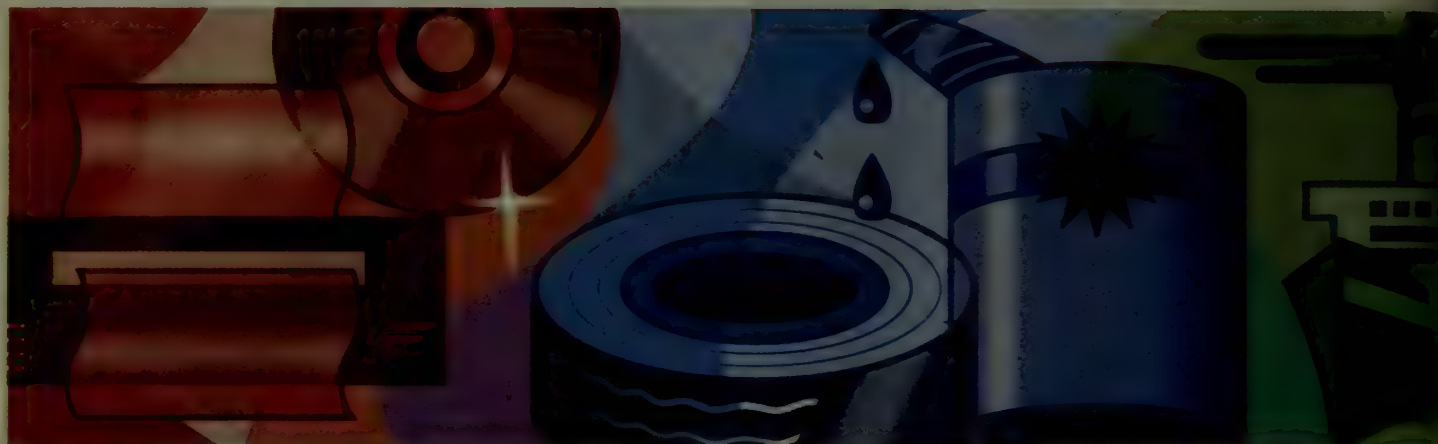
the current fiscal year ending Mar. 31.

Eddington may have wanted to go further. He has told colleagues BA needs to drastically pare its loss-making European short-haul services. BA Chairman Colin Marshall may have thwarted more radical steps. But Marshall, 68, won't be able to protect forever the empire he helped build.

PRIME MINISTER IN TROUBLE?

► The much publicized war-crimes trial of former Yugoslav President Slobodan Milosevic, which opened on Feb. 12 in The Hague, could undermine

Serbian Prime Minister Zoran Djindjic's already shaky political situation at home. Most Serbs have little sympathy for Milosevic, but view The Hague tribunal as an anti-Serb show trial. Since Djindjic engineered Milosevic's extradition under pressure from the U.S. last year, Serbs partly blame the Prime Minister for the bad publicity. Although Djindjic's popularity rating is just 14%, he is pressing ahead with an unpopular economic restructuring that could hike unemployment above 30%. That could hurt Djindjic just before new elections expected this fall.



THIS IS SO NOT THE '90s

Corporate earnings cratered in 2001—and things may not improve anytime soon

Corporate profits could have been worse in 2001—but it's hard to see how. With the economy steeped in recession, burdened with overcapacity, and whipsawed by uncertainty and fear after the brutal terrorist attacks of September 11, yearly earnings for *BusinessWeek's* 900 Corporate Score-

board companies plunged 59% from 2000. That decline was the steepest since the Scoreboard began in 1973, far outpacing the previous worst annual drop of 19% in recession-wracked 1991. In the fourth quarter alone, earnings plummeted 56%—the third straight quarter that profits fell by more than 50%, year to year.

Virtually every sector in the economy saw profits fall or turn to losses. Technology, transportation, and manufacturing were particularly hard hit. Of three sectors, buoyed by resilient consumer spending, did well—health care, utilities, and consumer staples. Nevertheless, total Scoreboard revenue

The Leaders in 2001 Sales and Profits

THE TOP 25 IN SALES

		2001 SALES IN MILLIONS	PERCENT CHANGE FROM 2000	2000 RANK
1	WAL-MART STORES	210,144	13	2
2	EXXON MOBIL	191,158	-9	1
3	GENERAL MOTORS	177,260	-4	3
4	FORD MOTOR	162,412	-4	4
5	GENERAL ELECTRIC	125,913	-3	5
6	CITIGROUP	112,022	0	6
7	CHEVRONTXACO	97,863	-11	17
8	IBM	85,866	-3	8
9	PHILIP MORRIS	72,944	15	11
10	VERIZON COMMUNICATIONS	67,190	4	10
11	AMERICAN ELECTRIC POWER	61,300	67	129
12	DUKE ENERGY	59,503	21	18
13	BOEING	58,198	13	15
14	EL PASO	57,475	18	80
15	AIG	55,459	10	21
16	BANK OF AMERICA	52,641	-9	13
17	AT&T	52,550	-5	9
18	KROGER	50,661	7	20
19	HOME DEPOT	50,528	14	24
20	J.P. MORGAN CHASE	50,429	-16	12
21	CARDINAL HEALTH	49,847	16	38
22	McKESSON	48,419	21	29
23	MERCK	47,716	18	28
24	SBC COMMUNICATIONS	45,908	-11	14
25	HEWLETT-PACKARD	45,226	-7	19

THE TOP 25 IN EARNINGS

		2001 PROFITS IN MILLIONS	PERCENT CHANGE FROM 2000	2000 RANK
1	EXXON MOBIL	15,105	-6	1
2	CITIGROUP	14,284	6	2
3	GENERAL ELECTRIC	14,128	11	3
4	PHILIP MORRIS	8,566	1	7
5	Pfizer	7,752	108	28
6	IBM	7,723	-5	8
7	MERCK	7,282	7	11
8	SBC COMMUNICATIONS	7,260	-9	9
9	BANK OF AMERICA	6,792	-10	10
10	WAL-MART STORES	6,486	4	13
11	MICROSOFT	6,082	-39	6
12	JOHNSON & JOHNSON	5,668	14	19
13	AIG	5,499	-17	15
14	TYGO INTERNATIONAL	5,124	8	20
15	DUPONT	4,328	87	43
16	COCA-COLA	3,979	83	47
17	CHEVRONTXACO	3,931	-49	18
18	MORGAN STANLEY DEAN WITTER	3,610	-34	16
19	WELLS FARGO	3,423	-15	26
20	PROCTER & GAMBLE	2,976	-18	29
21	BOEING	2,826	83	49
22	LILLY (ELJ)	2,809	-8	35
23	HOME DEPOT	2,799	4	40
24	WASHINGTON MUTUAL	2,732	44	55
25	BANK ONE	2,682	NM	583

Data: Standard & Poor's COMPUSTAT



ch fell 4% in the last quarter, managed only a sluggish 3% climb for all of 2001. And yearlong profit margins crumbled to a paltry 2.6%, from 6.5% in 2000. Profits took a big hit, owing to JDS Uniphase Corp., the maker of telecom optical components that posted an unprecedented \$58 billion in losses for the year, mostly a result of write-offs from acquisitions. But according to Standard & Poor's COMPUSTAT, 35 Scoreboard companies had special pretax write-offs of more than \$1 billion in 2001. Scoreboard profits would have sunk 47% for the year, counting just JDS's net loss, and 22% if special pretax charges were excluded. Facing such a bleak picture, corporate executives moved quickly throughout the year to shutter plants, slash capital spending, and lay off workers. But just when many thought the worst was over, the terrorist attacks punished the economy even more. Gross domestic product contracted 1.3% in the third quarter. Employers, who had already cut nearly 1 million workers before Labor Day, shed off another 350,000 jobs after September 11, especially in besieged industries like airlines.

Even some of the most profitable companies last year aren't home free. With energy prices off, Exxon Mobil Corp., which made more money than any company in U.S. history in 2000, saw earnings fall 6%, to \$15.1 billion in 2001, a pattern repeated at many oil companies. At General Electric Co., which saw earnings grow 11%, to \$14.1 billion, CEO Jeffrey R. Immelt expresses concern that the downturn could still affect the company: "We are doing our business planning as if 2002 is going to be as tough the entire year." And while drugmaker Pfizer's profits grew 108%, to \$8 billion—powered in part by surging sales of its cholesterol-lowering drug Lipitor—profits from such blockbusters are always endangered by patent expirations and competitive products. A new cholesterol drug from England's Astra-

Zeneca PLC, for instance, is expected to hit the market later this year.

In the technology sector, 2002 could be just as bad as 2001. As early as last spring, business customers had begun forgoing technology upgrades, putting a serious crimp in the profit-and-loss statements of many computer manufacturers, chipmakers, and telecom enterprises. Slammed especially hard were the telecom-equipment makers, who, after the boom years of the late '90s, have seen profits evaporate. JDS Uniphase's huge loss differed from others' only in scale. Motorola Inc., for instance, racked up \$3.9 billion in losses, down from a profit of \$1.3 billion in 2000, because of soft demand for its semiconductors and cellular gear. Beleaguered Lucent Tech-

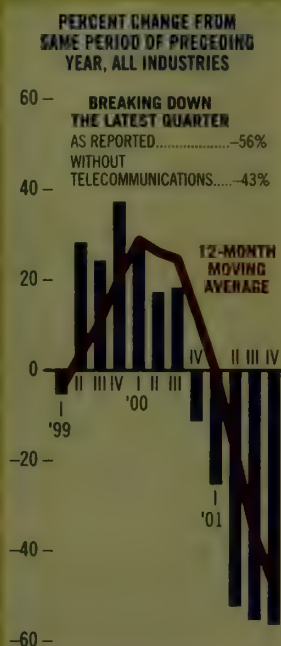
nologies' loss widened to \$13 billion, from \$1.1 billion, while VeriSign Inc. lost \$13.4 billion in 2001, after losing \$3.1 billion in 2000.

And the telecom operators themselves turned into basket cases as business spending for telecom services skidded. At Level 3 Communications Inc., the loss grew to \$5.4 billion, from \$1.4 billion a year earlier, with similar bloodbaths at Sprint, AT&T, and Qwest Communications International. And things will likely get worse before they get better. "We're within a few feet of the bottom of the ocean," says James Q. Crowe, CEO of Level 3. But clearly, it will be a long swim back to the surface.

The airlines, already hurt by a cut-back in business travel before the Sep-

A Spotlight on 2001 Profits

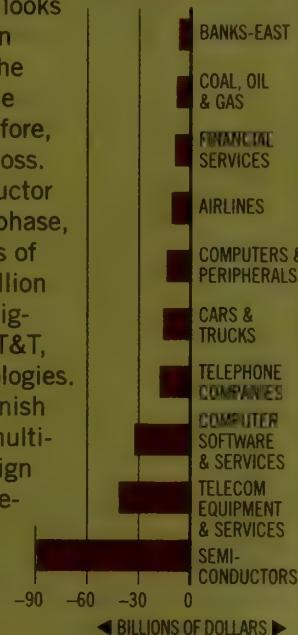
AFTERTAX PROFITS QUARTER BY QUARTER



INDUSTRIES WITH THE BIGGEST DOLLAR CHANGE IN 2001

Have we hit bottom yet? Well, this is what the bottom line looks like for 2001: earnings down 59%, revenues up 3%. Of the 65 industry groups, 46 made less money than the year before, and 11 of those reported a loss. Worst off was the semiconductor industry, thanks to JDS Uniphase, whose extensive write-downs of acquisitions led to a \$58 billion loss. Telecom was another big-time loser, with red ink at AT&T, Corning, and Lucent Technologies. Software also managed to finish near the bottom thanks to multi-billion-dollar losses at VeriSign and Cisco Systems. Early predictions say things will look better by the second half of 2002. We can only hope.

CHANGE IN AFTERTAX PROFITS FROM 2000



Data: Standard & Poor's COMPUSTAT

Corporate Scoreboard

tember 11 attacks, saw a devastating decline in traffic afterwards. Only one major carrier, low-cost Southwest Airlines Co., made money last year—and its \$511 million profit represented a decline of 18%. The biggest loser? UAL Corp., parent of United Airlines, which lost a record \$2.1 billion in 2001, even after an emergency government bailout. And AMR Corp., parent of American Airlines, the world's largest airline, lost \$1.8 billion for the year—\$798 million in the fourth quarter alone. "It does seem that all carriers are feeling the pain," says Thomas W. Horton, AMR's chief financial officer. Horton didn't offer a bright forecast for the first quarter of 2002. "Clearly, the first quarter will be a loss for us and the rest of the industry—and quite a substantial loss."

The auto industry also ran out of gas. Detroit resorted to 0% financing late last year to jump-start sales, but earnings still stalled. Ford Motor Co., hurt by the massive Firestone tire recalls, saw a \$5.4 billion profit in 2000 turn

Billions Down the Drain

The biggest losers of 2001

COMPANY	LOSS BILLIONS
JDS UNIPHASE	\$57.6
VERISIGN	13.4
LUCENT TECHNOLOGIES	13.0
CORNING	5.5
FORD MOTOR	5.5
LEVEL 3 COMMUNICATIONS	5.4
ADERE SYSTEMS	5.0
AOL TIME WARNER	4.9
AT&T	4.1
QWEST COMMUNICATIONS INTL.	3.9

Data: Standard & Poor's COMPUSTAT

into a \$5.5 billion loss in 2001. General Motors Corp. fared little better. It eked out a \$601 million profit—but that was an 87% decline, year to year, while revenues fell 4%.

The news was better at financial companies with big consumer operations, as

low interest rates served to spur lending. Citigroup saw profits rise 6%, \$14.3 billion. And at Washington Mutual Inc., earnings rose 44%, to \$2.7 billion thanks to the refinancing boom. But was another story on Wall Street. At the fat years of the late '90s, the market train stopped. Morgan Stanley Dean Witter's profits fell 34%, to \$3.6 billion. Profits at Merrill Lynch & Co. plummeted by 85%, to \$573 million.

Despite all the pain, there were faint signs of a rebound in the fourth quarter. Gross domestic product, surprisingly, grew by 0.2%. Consumer spending climbed at a 5.4% annual rate. There was even a small uptick in the technology sector. So the profit picture isn't at least, be getting no worse. Says S. Won Sohn, chief economist of Wells Fargo & Co.: "The recession ended in the final quarter of last year. Now we're in recovery." After the pummeling '01, it would be nice if he were right.

By Julie Forster and Michael Arndt in Chicago, with bureau reports

WHY THE BOUNCEBACK WON'T BE QUICK

On Jan. 30, the Federal Reserve left interest rates unchanged after 11 rate cuts, and investors cheered. The Fed's hands-off approach to monetary policy this time around signaled to many that the economy had bottomed out. And that perception was significantly reinforced by shrinking inventories, which in late 2001 were 4.1% below their high point a year earlier, according to Commerce Dept. statistics. With inventories fast declining, Corporate America would soon begin ramping up production, with higher profits sure to follow.

Not quite. Despite the impressive falloff in inventories, business profits aren't likely to come charging back. Why? Inventories may well fall even further. Many companies are afraid that history will repeat itself. They got burned once when they began restocking at a rapid clip in late 1999 in anticipation of disruptions from the Y2K computer virus—which never came. Last year's economic slowdown dampened demand. Then, after the September 11 attacks, businesses turned gun-shy about rebuilding inventories, fearing the economy-deadening aftereffects of terrorism. So now, cautious managers are likely to

let their inventory levels fall at least through the summer, and maybe longer, say economists. "Firms don't see demand turning up quickly," says David Huether, chief economist at the National Association of Manufacturers. "Growth in profits will be gradual."

Working off excess capacity in the hard-hit telecom sector, where many companies wildly overestimated demand last year, could delay a profit rebound for years at such companies as JDS Uniphase, Ciena, or Corning. But worries about demand also exist in healthier sectors of the economy. Heavy equipment maker Deere & Co., for instance, says it will rebuild inventories only as orders come in. In fiscal 2001, the company cut stocks by \$400 million, or 7%. This year, the goal is to lower inventory by an additional \$400 million. "As things turn up, we may not turn up our production as much as generally thought," says Chief Financial Officer Nathan J. Jones.

Not everyone is cutting. General Motors Corp. says it will increase first-quarter production by 20,000 vehicles, to 1.32 million, an 8.7% increase year to year.

And Fortune Brands Inc., a maker of office supplies such as Swingline Staplers, expects inventories to pick up soon. Fortune Brands CEO Norman H. Wesley notes that buyers have been emptying stockrooms for over a year now. "We should be at a point where, particularly when the economy turns, we should

see the reverse effect and see some positive growth," Wesley says.

Overall, Diane C. Swonk, chief economist at Bank One, expects inventory investment to stay negative until the third quarter, when she forecasts a reversal—and corporate profits rising 4.8% year to year. In other words, Corporate America will eventually restock its shelves and recover. Just don't look for it until late in the year.

By Laura Cohn in Washington, with Michael Arndt in Chicago

CUTTING BACK ON INVENTORIES



Data: U.S. Commerce Dept., Bank of Tokyo-Mitsubishi

Fourth Quarter & Full Year 2001

CORPORATE SCOREBOARD

Glossary

SALES: Includes all sales and operating revenues. For banks, includes all operating revenues.

FITS: Net income before extraordinary items. For banks,

profits are net income after security gains or losses.

MARGINS: Net income from continuing operations before extraordinary items as percent of sales.

RETURN ON COMMON EQUITY: Ratio of net income available

for common stockholders (most recent 12 months) to latest available common equity, which includes common stock, capital surplus, and retained earnings.

PRICE-EARNINGS RATIO: Based on Feb. 7, 2002, common-

stock price and corporate earnings from continuing operations before extraordinary items for most recent 12-month period.

EARNINGS PER SHARE: For most recent 12-month period. Includes all common-stock equivalents.

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 12-31	PRICE-EARNINGS RATIO 2-7	12 MONTHS' EARNINGS PER SHARE
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
INDUSTRY COMPOSITE	1756924.7	-4	7152669.2	3	38787.9	-56	185018.4	-59	2.2	4.8	5.7	58	0.58
AEROSPACE & DEFENSE													
INDUSTRY COMPOSITE	45158.7	12	163820.4	12	692.8	-62	6635.3	5	1.5	4.5	13.0	22	2.31
BAE SYSTEMS ATK (8)	464.1	58	1610.8	43	22.0	24	78.5	19	4.7	6.4	16.4	24	3.50
BOEING BA	15702.0	7	58198.0	13	100.0	-79	2826.0	33	0.6	3.3	26.1	12	3.41
GENERAL DYNAMICS GD	3508.0	30	12163.0	17	246.0	12	943.0	5	7.0	8.1	21.3	18	4.65
LOCKHEED GR	1052.8	10	4184.5	13	-51.1	NM	176.9	-25	NM	6.4	11.4	16	1.65
LOCKHEED MARTIN LMT	7334.0	11	23990.0	-2	-146.0	NM	79.0	NM	NM	2.9	5.5	NM	0.18
ORTHROP DRUMMAN MOD	4304.0	93	13558.0	78	131.0	-9	427.0	-32	3.0	6.5	5.5	23	4.80
PRECISION CASTPARTS PCP (8)	625.8	8	2556.1	14	-59.1	NM	32.9	-71	NM	4.5	3.4	42	0.63
RAYTHEON RYN	4631.0	5	16867.0	0	57.0	-70	5.0	-99	1.2	4.3	0.0	NM	0.01
RAYWELL COLLINS COL (3)	563.0	-4	2796.0	10	48.0	-17	129.0	-50	8.5	9.9	16.4	NA	N/A
UNITED TECHNOLOGIES UTX	6974.0**	8	27897.0	5	345.0	-19	1938.0	7	4.9	6.3	22.8	18	3.83
AUTOMOTIVE													
INDUSTRY COMPOSITE	117715.4	-3	463570.2	-5	-5373.9	NM	-5129.9	NM	NM	1.0	-9.1	NM	-1.20
CARS & TRUCKS													
GROUP COMPOSITE	91086.3	-2	354901.1	-5	-4739.4	NM	-4625.2	NM	NM	1.2	-12.6	NM	-1.68
CHRYSLER F	41150.0	-3	162412.0	-4	-5068.0	NM	-5453.0	NM	NM	2.5	-40.9	NM	-3.02
GENERAL MOTORS GM	45950.0**	11	177260.0	-4	255.0	187	601.0	-87	0.6	0.2	2.9	27	1.77
INACO COACH INC	261.6	24	937.1	4	7.6	-12	24.9	-41	2.9	4.1	11.7	31	0.85
VISTAR INTERNATIONAL NAV (2)	1827.0	-7	6679.0	-21	7.0	NM	-23.0	NM	0.4	NM	-2.0	NM	-0.39
MAHINDRA TRUCK OTRKB (3)	361.5	58	1524.3	11	8.6	5	51.2	1	2.4	2.9	14.6	18	2.99
VEICAR PCAR	1536.2	-8	6088.8	-23	50.4	-20	173.6	-61	3.3	3.8	7.7	29	2.26
PARTS & EQUIPMENT													
GROUP COMPOSITE	22130.8	-4	90402.3	-6	-493.6	NM	-363.1	NM	NM	0.7	-2.4	NM	-0.31
AMERICAN AXLE & MFG. HOLDINGS AXL	791.6	7	3107.2	1	31.4	26	114.9	-11	4.0	3.4	21.5	10	2.36
WINN-DIXIE ARM (3)	1566.0	-6	6712.0	18	11.0	NM	56.0	-50	0.7	NM	9.0	27	0.86
VALVOLVO ALV	969.8	-3	3991.0	-3	26.5	36	47.9	-72	2.7	1.9	2.6	42	0.49
WARNER BWA	582.8	-2	2351.6	-11	2.2	-71	66.4	-29	0.4	1.3	6.0	21	2.51
CPH AUTOMOTIVE SYSTEMS CPH	6380.0	-8	26088.0	-10	-131.0	NM	-370.0	NM	NM	2.9	-16.0	NM	-0.66
CPH AUTOMOTIVE SYSTEMS CPH	580.3	-11	2477.4	-6	-7.5	NM	11.2	-73	NM	0.5	2.5	17	0.62
ETN	1695.0	-13	7299.0	-12	30.0	-48	169.0	-53	1.8	3.0	6.8	30	2.39
LEA	3405.0	1	13624.7	-3	-48.8	NM	34.2	-88	NM	2.2	2.2	75	0.52
MODINE MFG. MOD (8)	270.4	1	1077.0	-5	1.3	-82	22.8	-63	0.5	2.7	4.4	36	0.70
INCO AUTOMOTIVE TEN	758.0	-10	3364.0	-5	-99.0	NM	-130.0	NM	NM	NM	NM	NM	-3.43
POWER AUTOMOTIVE TWR	638.9	1	2467.4	-3	-295.7	NM	-267.5	NM	NM	NM	-57.9	NM	-5.87
STON VC	4493.0	-1	17843.0	-8	-14.0	NM	-118.0	NM	NM	NM	-3.6	NM	-0.91
TIRE & RUBBER													
GROUP COMPOSITE	4498.3	-2	18266.8	-3	-140.9	NM	-141.6	NM	NM	NM	-3.0	NM	-0.55
GOODYEAR	249.2	-1	964.9	-3	17.4	18	43.8	-27	7.0	5.8	9.0	16	2.12
GOODYEAR TIRE & RUBBER GTB	776.6	-5	3154.7	-9	15.7	148	18.2	-81	2.0	0.8	2.0	59	0.25
GOODYEAR TIRE & RUBBER GT	3472.6	-2	14147.2	-2	-174.0	NM	-203.6	NM	NM	NM	-6.1	NM	-1.27

Fourth quarter ended Nov. 30. (2) Fourth quarter ended Oct. 31. (3) First quarter and most recent 12 months ended Dec. 31. (4) First quarter and most recent 12 months ended Nov. 30. (5) First quarter and most recent 12 months ended Oct. 31. (6) Second quarter and most recent 12 months ended Dec. 31. (7) Second quarter and most recent 12 months ended Nov. 30. (8) Second quarter and most recent 12 months ended Oct. 31. (9) Third quarter and most recent 12 months ended Dec. 31. (10) Third quarter and most recent 12 months ended Nov. 30. (11) Third quarter and most recent 12 months ended Oct. 31. *Sales include excise taxes. **Sales include other income. ***Sales include excise taxes and other income. †Revenues from major subsidiaries not included in consolidated sales. Earnings per share are for latest 12 months, not necessarily for end of most recent fiscal year; they include all common-stock equivalents but exclude extraordinary items. NA = not available. NM = not meaningful

Data: Standard & Poor's COMPUSTAT

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		PER COMMON EQUITY 12-31	PRICE/EARNINGS RATIO 2-7	MONTHLY EARN PER SH
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
3 BANKS													
INDUSTRY COMPOSITE	77741.7	-16	331375.3	-7	8219.0	-12	35346.3	-11	10.6	10.1	11.4	19	1
(A) BANKS - EAST													
GROUP COMPOSITE	21894.7	-26	99960.2	-13	523.2	-81	7570.1	-46	2.4	9.5	8.9	25	1
ASSOCIATED BANC-CORP ASBC	256.0	-10	1076.2	-4	46.3	17	179.5	7	18.1	13.9	16.8	13	2
BANK OF NEW YORK BK	1777.0**	-8	7192.0	-4	331.0	-11	1343.0	-6	18.6	19.2	21.3	21	1
BANKNORTH GROUP BRNG	378.1	-6	1504.3	-3	65.5	5	243.0	27	17.3	15.5	13.6	14	1
COLONIAL BANCORP CNB	237.8	-9	995.9	0	31.9	0	122.7	0	13.4	11.3	14.4	17	1
FLEETBOSTON FINANCIAL FBE	3839.0**	-36	19133.0	-26	-507.0	NM	931.0	-76	NM	14.8	5.2	38	0
J.P. MORGAN CHASE JPM	10456.0	-35	50429.0	-16	-332.0	NM	1719.0	-70	NM	4.4	4.1	36	0
M&T BANK MTB	619.4	-4	2579.3	23	101.7	41	378.1	32	16.4	11.1	12.9	19	3
MBNA BB	2751.1	24	10144.7	27	524.8	24	1694.3	29	19.1	19.1	21.5	17	1
NORTH FORK BANCORPORATION NFB	310.3**	2	1218.8	5	90.0	21	331.5	41	29.0	24.4	23.1	16	2
STATE STREET STT	1270.0**	-19	5687.0	-4	171.0	16	628.0	6	13.5	9.4	16.4	27	1
(B) BANKS - MIDWEST													
GROUP COMPOSITE	25612.4	-11	105642.1	-3	3551.8	25	12559.1	4	13.9	9.9	12.5	21	1
BANK ONE ONE	5791.0	-10	24527.0	-3	541.0	NM	2682.0	NM	9.3	NM	13.2	15	2
COMERICA CMA	960.5**	-19	4165.6	-10	199.0	15	709.6	-10	20.7	14.5	14.5	14	3
COMMERCE BANCSHARES CBN	242.9**	-11	1028.5	-3	46.8	1	182.0	2	19.3	16.9	14.3	15	2
FIFTH THIRD BANCORP FITB	1559.9	-7	6506.3	1	385.7	21	1100.6	-4	24.7	19.0	14.0	33	1
HUNTINGTON BANCSHARES HBAN	576.8	-14	2449.0	-6	65.6	-14	178.5	-46	11.4	11.4	7.4	24	0
KEYCORP KEY	1627.1**	-25	7351.5	-13	-174.2	NM	156.6	-84	NM	12.3	2.4	62	0
MARSHALL & ILSLEY MI	664.3	-6	2728.0	0	108.3	28	337.5	7	16.3	11.9	12.9	19	3
NATIONAL CITY NCC	2188.8	-7	9092.6	0	346.6	13	1388.1	7	15.8	13.1	11.8	12	2
NORTHERN TRUST NTRS	728.7**	-22	3261.5	-8	102.4	-18	487.5	0	14.1	13.4	18.2	26	2
TCF FINANCIAL TCF	292.3**	-6	1198.1	0	54.2	0	207.3	11	18.5	16.8	22.8	18	2
U.S. BANCORP USB	3843.0	-13	16443.0	-3	695.4	-10	1706.5	-41	18.1	17.4	10.4	22	0
WELLS FARGO WFC	7137.0	-5	26891.0	-2	1181.0	5	3423.0	-15	16.5	15.0	12.5	23	1
(C) BANKS - SOUTH & SOUTHEAST													
GROUP COMPOSITE	27965.3	-8	114039.9	-5	4309.2	30	14186.3	15	15.4	10.8	12.3	15	2
AMSOUTH BANCORPORATION ASO	793.7**	-14	3382.8	-10	140.5	11	536.3	63	17.7	13.8	18.1	14	1
BANK OF AMERICA BAC	12203.0	-16	52641.0	-9	2057.0	49	6792.0	-10	16.9	9.6	14.0	14	4
BB&T BBT	1500.0	-4	6228.2	9	277.9	20	973.6	39	18.5	14.9	15.8	16	2
FIRST TENNESSEE NATIONAL FTN	634.3**	27	2378.2	12	89.2	24	329.6	42	14.1	14.3	22.9	13	2
HIRERNIA HIB	348.5	-9	1477.5	1	56.4	224	218.8	25	16.2	4.5	13.7	13	1
NATIONAL COMMERCE FINANCIAL NCF	379.9	-6	1547.8	37	59.9	NM	225.3	397	15.8	NM	5.2	23	1
POPULAR BPOP	617.9	-9	2561.4	-2	75.6	0	303.9	10	12.2	11.1	13.4	13	2
REGIONS FINANCIAL RGN	1004.0	2	4037.5	5	138.2	8	508.9	-4	13.8	13.0	12.8	13	2
SOUTHTRUST SOTR	892.8	-11	3741.8	-4	144.9	18	554.5	15	16.2	12.3	14.2	15	1
SUNTRUST BANKS STI	1948.8	-13	8435.4	-2	332.6	1	1369.2	6	17.1	14.7	16.4	13	4
SYNOVUS FINANCIAL SNV	519.3	0	2068.6	7	85.2	14	311.6	19	16.4	14.4	18.4	26	1
UNION PLANTERS UFG	752.1	-6	3143.8	2	115.9	12	443.6	8	15.4	13.0	13.8	14	3
WACHOVIA WB	6371.0**	6	22396.0	-8	736.0	14	1619.0	NM	11.6	10.7	5.7	21	1
(D) BANKS - WEST & SOUTHWEST													
GROUP COMPOSITE	2269.3	-31	11733.2	-5	-165.2	NM	1030.8	-26	NM	10.1	11.1	13	1
PACIFIC CENTURY FINANCIAL PCF	249.7	-25	1280.9	-3	26.3	-19	117.8	0	10.5	9.8	9.4	18	1
PROVIDENT FINANCIAL PVN	857.2	-48	5529.9	-7	-395.3	NM	141.4	-79	NM	13.5	5.7	7	0
UNIONBANCAL UB	681.3	-14	2911.7	-8	131.9	NM	481.4	9	19.4	1.1	13.6	12	3
ZIONS BANCORPORATION ZION	481.1	-5	2010.7	5	71.9	9	290.2	79	14.9	13.0	12.7	16	3
4 CHEMICALS													
INDUSTRY COMPOSITE	27616.0	-8	118073.9	-5	3806.4	636	4819.2	-33	13.8	1.7	9.3	27	1
AIR PRODUCTS & CHEMICALS APD (3)	1316.5	-11	5592.4	-2	113.7	-16	491.0	135	8.6	9.2	15.8	21	2
ALBEMARLE ALB	239.2	0	916.9	0	14.1	-11	68.2	-33	5.9	7.2	11.5	18	1
CABOT CBT (3)	377.0	-5	1652.0	4	38.0	0	132.0	26	10.1	7.1	13.8	13	1
CROMPTON CR	604.9	-17	2718.8	-11	-85.4	NM	-123.9	NM	NM	NM	-22.6	NM	-1
CYTEC INDUSTRIES CYT	314.8	-12	1387.1	-7	6.8	-91	66.2	-63	2.2	21.5	10.4	14	1
DOW CHEMICAL DOW	6346.0**	-12	27805.0	-6	-37.0	NM	-417.0	NM	NM	2.1	-4.2	NM	-0
DUPONT DD	5229.0**	-17	24726.0	-13	3915.0	NM	4328.0	87	74.9	4.1	35.6	10	4
EASTMAN CHEMICAL EMN	1271.0**	-7	5384.0	0	-92.0	NM	-179.0	NM	NM	3.8	-13.0	NM	-2
FERRO FOE	409.9	13	1501.1	0	6.0	-64	39.2	-46	1.5	4.5	15.1	24	1
FULLER (H.B.) FULL (1)	322.9	-11	1274.1	-7	12.9	-9	44.9	-9	4.0	3.9	10.4	18	1
GEORGIA GULF GGC	232.2	-36	1205.9	-24	-5.0	NM	-12.0	NM	NM	NM	-12.7	NM	-0
GRACE (W.R.) GRA	429.1	0	1723.2	8	21.2	NM	78.6	NM	4.9	NM	NM	0	1
GREAT LAKES CHEMICAL GLK	342.5	-15	1594.7	-5	-31.8	NM	-271.9	NM	NM	5.9	-44.2	NM	-5
HERCULES HPC	611.0	-15	2620.0	-17	6.0	NM	-52.0	NM	1.0	NM	-7.1	NM	-0
IMC GLOBAL IGL	525.8	0	1958.7	-7	-13.9	NM	-27.9	NM	NM	0.9	-5.2	NM	-0
INTERNATIONAL FLAVORS & FRAGRANCES IFF (1)	419.2	0	1843.8	0	29.2	NM	116.0	-6	7.0	0.4	22.1	27	1
LUBRIZOL LZ	439.8	-2	1844.6	4	20.8	-37	94.1	-20	4.7	7.4	12.2	18	1



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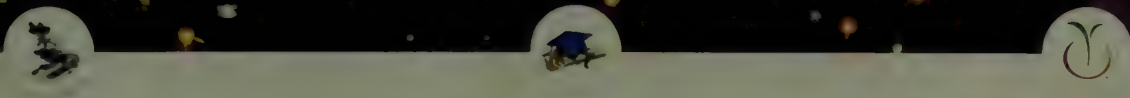
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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURNS ON COMMON EQUITY	PRICE/ EARNINGS RATIO	12 MONTHS EARNING PER SHARE
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %	12 MONTHS ENDING 12-31		
LYONDELL CHEMICAL LYO †	717.0	-24	3226.0	-20	-48.0	NM	-145.0	NM	NM	NM	-19.4	NM	-1.24
MILLENNIUM CHEMICALS MCH	334.0	-23	1590.0	-11	8.0	-43	-43.0	NM	2.4	3.2	-4.9	NM	0.68
MONSANTO MON	1209.0	4	5462.0	-1	-104.0	NM	297.0	70	NM	NM	0.0	27	1.13
OM GROUP OMG	1081.9	365	2367.4	167	20.0	3	80.2	12	1.8	8.3	14.0	19	3.28
POLYONE POL	589.9	-16	2654.6	41	-30.1	NM	-46.1	NM	NM	NM	-6.5	NM	-0.51
PRAXAIR PX	1238.0	-3	5158.0	2	118.0	NM	432.0	19	9.5	0.4	17.4	21	2.63
ROHM & HAAS ROH	1340.0**	-12	5666.0	-11	37.0	-38	-70.0	NM	2.8	4.0	-1.8	NM	-0.31
SCHULMAN (A.) SHLM (4)	238.1	-7	956.8	-6	5.2	NM	18.6	-26	2.2	NM	5.5	27	0.64
SOLUTIA SOI	643.0	-12	2817.0	-12	-101.0	NM	-59.0	NM	NM	NM	NM	NM	-0.57
TERRA INDUSTRIES TRA	234.2**	-14	1037.3	-2	-26.8	NM	-77.7	NM	NM	1.5	-15.5	NM	-1.03
USEC USU (6)	560.1	45	1390.6	-2	9.5	-55	57.7	NM	1.7	5.4	6.0	8	0.71
5 CONGLOMERATES													
INDUSTRY COMPOSITE	50874.2	0	232567.5	-1	5956.2	26	19747.4	-3	9.8	7.7	18.1	24	1.45
ANIXTER INTERNATIONAL AXE	662.6	-23	3144.2	-11	5.7	-64	33.6	-57	0.9	1.8	5.0	31	0.89
GENERAL ELECTRIC GE	33975.0**	-3	125913.0	-3	3933.0	10	14128.0	11	11.6	10.2	26.4	26	1.41
HONEYWELL INTERNATIONAL HON	5853.0	-9	23652.0	-5	118.0	-54	-99.0	NM	2.0	3.9	-1.1	NM	-0.12
IKON OFFICE SOLUTIONS IKO (3)	1210.4	-8	5165.9	-5	32.6	101	30.4	-69	2.7	1.2	2.2	66	0.20
PALL PLL (5)	274.1	-1	1231.4	2	19.4	-24	111.8	-24	7.1	9.2	14.7	24	0.90
PEPSI AMERICAS PAB	761.4	19	3170.7	25	9.2	411	90.1	26	1.2	0.3	6.3	21	0.58
TEXTRON TXT	3183.0**	-4	12321.0	-6	257.0	NM	166.0	-40	8.1	NM	4.5	27	1.16
TRW TRW	4078.0	-1	16383.0	-5	90.0	NM	68.0	-84	2.2	NM	3.1	78	0.54
TYCO INTERNATIONAL TYC (3)	10068.1	25	38017.2	19	1453.8	45	5124.1	2	14.4	12.5	14.6	10	2.71
VIAD VVI	365.2	-12	1659.4	-4	25.2	-11	51.1	-64	6.9	6.9	6.9	42	0.38
WALTER INDUSTRIES WLT	443.4	-13	1909.7	-5	12.3	472	43.3	NM	2.8	0.4	10.5	11	0.95
6 CONSUMER PRODUCTS													
INDUSTRY COMPOSITE	92100.4	6	355379.0	6	7405.5	15	29110.6	2	8.0	7.4	26.7	24	1.31
(A) APPAREL													
GROUP COMPOSITE	5530.2	-1	26864.1	3	248.9	-29	1250.6	-3	3.8	5.3	13.6	22	1.78
BROWN SHOE BWS (11)	462.4	0	1748.2	7	11.9	-24	29.1	-18	2.6	3.4	10.1	9	1.66
JONES APPAREL GROUP JNY	887.0	-8	4073.0	-2	31.0	-51	236.0	-22	3.5	6.5	12.4	19	1.82
KELLWOOD KWD (11)	601.4	-14	2352.1	3	13.9	-48	39.3	-42	2.3	3.8	8.5	14	1.72
NIKE NKE (7)	2336.8	6	9603.9	4	129.3	2	593.6	-1	5.5	5.4	15.7	26	2.13
PHILLIPS-VAN HEUSEN PVH (11)	405.0	-9	1480.3	7	12.6	-35	26.7	2	3.1	4.4	9.3	11	0.96
POLO RALPH LAUREN RL (8)	617.1	1	2269.1	5	45.6	-10	172.0	295	7.4	8.2	18.2	15	1.75
REEBOK INTERNATIONAL RBR	664.6	7	2992.9	4	5.2	-16	102.7	27	0.8	1.0	14.3	17	1.66
RUSSELL RML	314.8	-4	1160.9	-5	-30.8	NM	-55.5	NM	NM	3.4	-12.2	NM	-1.74
TIMBERLAND TBL	341.1	3	1183.6	2	30.2	-26	106.7	-14	8.9	12.4	29.7	12	0.85
(B) APPLIANCES & HOME FURNISHINGS													
GROUP COMPOSITE	16352.6	11	62801.1	7	359.6	9	1476.4	-34	2.2	2.2	11.1	35	1.00
BED BATH & BEYOND BBBY (10)	759.4	26	2795.0	26	53.0	30	201.2	29	7.0	6.8	20.3	19	0.68
BEST BUY BBY (10)	4756.0	27	18078.6	27	80.0	10	409.7	11	1.7	1.5	19.1	26	1.92
CIRCUIT CITY GROUP CC (10)	2279.9	-2	9375.2	-13	21.1	NM	139.3	-33	0.9	NM	5.8	41	0.68
FURNITURE BRANDS INTERNATIONAL FBN	476.8	-8	1891.3	-11	22.8	-6	58.0	-46	4.8	4.7	7.6	21	1.13
HARMAN INTERNATIONAL INDUSTRIES HAR (8)	467.4	7	1749.8	3	11.7	-51	17.7	-77	2.5	5.5	4.0	25	0.51
KIMBALL INTERNATIONAL KBALB (6)	296.6	-11	1189.9	-8	6.5	-47	4.8	-90	2.2	3.7	1.1	NM	0.13
LA-Z-BUY LZB (8)	559.2	-6	2165.0	2	12.4	-57	41.6	-55	2.2	4.9	6.0	31	0.59
LEGGETT & PLATT LEG	968.5	-4	4113.8	-4	35.4	-22	187.6	-29	3.7	4.5	10.1	25	0.94
LINENS 'N THINGS LIN	587.9	19	1823.8	16	8.2	-76	29.7	-54	1.4	7.0	6.0	20	0.72
MAYTAG MYG	1134.0	23	4323.7	2	23.8	NM	167.5	-23	2.1	NM	711.5	15	2.13
PIER 1 IMPORTS PIR (10)	387.4**	13	1500.5	10	25.0	6	87.7	-5	6.5	6.9	16.2	15	0.91
SALTON SFP (6)	318.5	21	839.5	2	21.2	-20	26.6	-66	6.7	10.1	11.0	12	1.52
TWEETER HOME ENTERTAINMENT TWTR (3) †	251.9	56	630.1	44	13.5	38	20.6	14	5.4	6.0	5.9	27	0.93
WHIRLPOOL WHR	2647.0	2	10343.0	2	21.0	-69	34.0	-19	0.8	2.6	2.3	NM	0.50
WILLIAMS-SONOMA WSM (11)	462.1	9	1981.8	15	3.9	65	50.2	-18	0.8	0.6	11.2	47	0.89
(C) BEVERAGES													
GROUP COMPOSITE	24129.4	4	91135.4	4	1931.4	49	9112.0	27	8.0	5.6	28.5	29	1.50
ANHEUSER-BUSCH BUD	2893.1	2	12911.5	2	227.8	9	1704.5	10	7.9	7.4	39.9	26	1.89
BROWN-FORMAN BF.B (8)	575.8	2	1933.4	1	80.1	0	229.7	0	13.9	14.0	18.4	20	1.38
COCA-COLA KO	4923.0	4	20092.0	1	914.0	278	3979.0	23	18.6	5.1	35.9	29	1.60
COCA-COLA ENTERPRISES COE	3967.0	11	15700.0	5	-36.0	NM	-19.0	NM	NM	0.4	-0.7	NM	-0.05
CONSTELLATION BRANDS STZ (10)	764.1	21	2691.0	13	49.6	42	127.8	35	6.5	5.6	14.1	17	0.99
COORS (ADOLPH) RKY	558.4	-4	2429.5	1	15.9	33	123.0	12	2.8	2.1	12.6	16	3.31
PEPSI BOTTLING GROUP PBG	2462.0	3	8443.0	5	13.0	225	305.0	33	0.5	0.2	19.6	22	1.03
PEPSICO PEP	7986.0	2	26935.0	4	667.0	-4	2662.0	5	8.4	8.9	30.7	33	1.47
(D) PERSONAL CARE													
GROUP COMPOSITE	23846.7	2	89031.2	1	2462.7	9	7711.8	-10	10.3	9.6	30.7	32	1.72
AVON PRODUCTS AVE	1751.5	2	5994.5	5	110.3	-44	430.3	-11	6.3	11.9	NM	27	1.79
CLOROX CLX (6)	901.0**	3	3956.0	-1	51.0	-20	290.0	-27	5.7	7.3	16.5	34	1.22



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things since the
first pecan pie.



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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON EQUITY 12 MONTHS ENDING 12-31	PRICE- EARNINGS RATIO 2-7	12 MONTH EARN- PER SHARE
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
COLGATE-PALMOLIVE CL	2414.4	0	9427.8	1	195.3	3	1146.6	8	12.2	11.9	242.0	29	1.1
DIAL DL	426.6	5	1663.3	9	25.3	NM	69.8	103	5.9	NM	93.7	21	0.1
ELIZABETH ARDEN RDN ⁽¹¹⁾	303.0	85	658.3	70	33.4	167	-10.1	NM	11.0	7.7	-11.8	NM	-0.1
ESTEE LAUDER EL ⁽⁶⁾	1257.4	-3	4583.9	2	90.1	-29	272.7	-20	7.2	9.9	17.0	32	0.1
GILLETTE G	2718.0	-3	8961.0	-3	200.0	NM	910.0	11	7.4	NM	43.1	33	0.1
KIMBERLY-CLARK KMB	3671.8	2	14524.4	4	358.3	-21	1626.5	-10	9.2	12.7	27.4	19	3.1
PROCTER & GAMBLE PG ⁽⁸⁾	10403.0	2	39262.0	-1	1299.0	9	2976.0	-18	12.5	11.7	22.4	39	2.1
(E) TOBACCO													
GROUP COMPOSITE	21141.5	12	85547.3	13	2402.8	10	9559.8	2	11.4	11.6	32.8	13	3.1
DIMON DMN ⁽⁶⁾	376.4	-27	1355.0	-3	6.2	-29	28.4	5	1.6	1.7	6.9	11	0.1
PHILIP MORRIS MO	17982.0	16	72944.0	15	2164.0	8	8566.0	1	12.0	13.0	43.1	13	3.1
R.J. REYNOLDS TOBACCO HOLDINGS RJR	2093.0	4	8585.0	7	89.0	53	444.0	25	4.3	2.3	5.4	13	4.1
STANDARD COMMERCIAL SW ⁽⁹⁾	242.8	-36	993.0	-16	5.9	4	29.9	78	2.4	1.5	15.6	8	2.1
UST UST	447.4	13	1670.3	11	137.7	20	491.6	11	30.8	29.0	108.5	11	2.1
7 CONTAINERS & PACKAGING													
INDUSTRY COMPOSITE	11607.5	-4	47443.9	-2	214.5	-54	1243.4	-9	1.8	3.9	7.4	26	0.1
(A) GLASS, METAL & PLASTIC													
GROUP COMPOSITE	2650.7	1	11029.6	-1	7.7	-86	303.3	NM	0.3	2.2	12.9	16	1.4
BALL BLL	1843.0	2	3685.1	1	8.1	-58	-99.2	NM	1.0	2.3	-21.4	NM	-3.4
OWENS-ILLINOIS OI	1346.4	1	5402.5	-3	-5.2	NM	360.7	NM	NM	2.4	20.2	5	2.1
SILGAN HOLDINGS SLGN	461.3	1	1941.0	3	4.8	-13	41.8	-18	1.0	1.2	267.6	12	2.1
(B) PAPER													
GROUP COMPOSITE	8956.8	-5	36414.3	-2	206.8	-50	940.1	-39	2.3	4.4	6.5	29	0.1
BEMIS BMS	558.6	-2	2293.1	5	39.1	17	140.3	7	7.0	5.8	15.8	10	2.1
GAYLORD CONTAINER GCR ⁽³⁾	243.2	-18	1052.4	-11	-8.6	NM	-37.5	NM	NM	0.5	NM	NM	-0.1
GREIF BROS. GBCOA ⁽²⁾	444.8	50	1456.0	51	14.3	-28	85.8	17	3.2	8.1	15.1	11	3.1
MAIL-WELL MWL	390.4	-17	1653.5	-9	-0.6	NM	-13.0	NM	NM	0.5	-5.4	NM	-0.1
PACKAGING CORP. OF AMERICA PKG	413.1	-11	1790.0	-7	19.0	-74	107.5	-38	4.6	16.0	14.4	18	0.1
PACTIV PTV	710.0	-9	2812.0	-8	46.0	557	165.0	115	6.5	0.9	11.8	17	1.1
POTLATCH PCH	394.9	-6	1752.0	-3	-31.7	NM	-79.4	NM	NM	NM	-11.2	NM	12.1
ROCK-TENN RKT ⁽³⁾	350.6	2	1447.0	-1	12.2	171	37.9	NM	3.5	1.3	9.2	15	1.1
SEALED AIR SEE	781.4	-2	3067.5	0	38.5	-38	156.7	-30	4.9	7.8	13.2	13	1.1
SMURFIT-STONE CONTAINER SSCC	1991.0	-11	8377.0	-5	17.0	-75	83.0	-62	0.9	3.1	2.9	NM	0.1
SONOCO PRODUCTS SON	676.6	1	2606.3	-4	27.2	-25	91.6	-45	4.0	5.4	11.4	17	0.1
TEMPLE-INLAND TIN	1000.0	-4	4172.0	-3	26.0	-26	111.0	-43	2.6	3.4	5.9	12	2.1
WESTVACO MWV ⁽²⁾	1002.4	-7	3935.5	2	8.4	-90	88.2	-65	0.8	7.5	5.8	17	0.1
8 DISCOUNT & FASHION RETAILING													
INDUSTRY COMPOSITE	171896.3	7	698796.7	11	3639.7	43	17253.3	-8	2.1	1.6	12.2	39	0.1
ABERCROMBIE & FITCH ANF ⁽¹¹⁾	354.5	-3	1337.7	15	43.9	1	166.7	0	12.4	12.0	32.7	18	1.1
ALBERTO-CULVER ACV ⁽³⁾	614.3	9	2514.9	10	29.3	24	116.0	16	4.8	4.2	15.5	14	2.1
AMAZON.COM AMZN	1115.2	15	3122.4	13	5.1	NM	-556.8	NM	0.5	NM	NM	NM	-1.1
AMERICAN EAGLE OUTFITTERS AEOS ⁽¹¹⁾	363.7	29	1331.3	59	30.7	5	110.7	35	8.5	10.3	24.6	16	1.1
AMES DEPARTMENT STORES AMESQ ⁽¹¹⁾	676.9**	-26	3607.2	-8	-336.2	NM	-785.5	NM	NM	NM	NM	NM	-26.1
ANN TAYLOR STORES ANN ⁽¹¹⁾	310.8**	2	1271.8	7	12.1	-49	33.2	-49	3.9	7.8	5.4	11	1.1
AUTOZONE AZO ⁽⁴⁾	1176.1	11	4930.7	11	84.1	55	205.8	-22	7.1	5.1	22.6	10	1.1
BARNES & NOBLE BKS ⁽¹¹⁾	995.6	5	4660.6	14	-6.8	NM	-54.0	NM	NM	NM	-6.7	NM	-0.1
BIG LOTS BLI ⁽¹¹⁾	773.1	5	3407.0	11	-16.4	NM	41.4	-56	NM	0.9	4.5	10	0.1
BJ'S WHOLESALE CLUB BJ ⁽¹¹⁾	1268.9	8	5242.6	12	-33.5	NM	80.0	-35	NM	2.3	12.3	10	1.1
BORDERS GROUP BGP ⁽¹¹⁾	713.7	2	3375.5	7	-3.1	NM	53.8	-45	NM	NM	6.4	14	0.1
BUILDING MATERIALS HOLDING BMMC	275.1	15	1092.9	11	4.3	207	20.8	11	1.6	0.5	8.7	8	1.1
BURLINGTON COAT FACTORY BCF ⁽⁷⁾	744.2	1	2445.1	11	41.3	-13	58.6	-23	5.5	6.5	8.7	12	1.1
CDW COMPUTER CENTERS CDW	988.2	-2	3961.5	11	41.9	0	168.7	4	4.2	4.2	21.7	27	1.1
CHARMING SHOPPES CHRS ⁽¹¹⁾	549.3	51	1781.4	17	0.2	-98	32.5	-36	0.0	2.0	5.7	20	0.1
CLAIRE'S STORES CLE ⁽¹¹⁾	234.0	-5	1042.1	0	2.4	-83	34.2	-55	1.0	5.6	8.7	16	0.1
COLE NATIONAL CNJ ⁽¹¹⁾	261.5	2	1103.9	11	-2.3	NM	3.6	NM	NM	NM	2.4	19	0.1
COSTCO WHOLESALE COST ⁽⁴⁾	8466.6**	11	35626.3	11	129.7	0	602.2	-5	1.5	1.7	12.0	14	1.1
CSK AUTO CAO ⁽¹¹⁾	366.7	-1	1456.6	11	5.9	1	-20.7	NM	1.6	1.6	-16.7	NM	-0.1
DILLARD'S DDS ⁽¹¹⁾	1930.2**	-6	8516.0	-3	-40.2	NM	24.2	-62	NM	NM	0.9	15	0.1
DOLLAR GENERAL DG ⁽¹¹⁾	1309.1	20	5178.6	21	46.7	2	77.9	-57	3.6	4.2	8.2	14	0.1
DOLLAR TREE STORES DLTR	714.8	19	1987.3	11	76.1	18	123.1	1	10.6	10.8	19.9	29	1.1
FAMILY DOLLAR STORES FDO ⁽⁴⁾	977.1	19	3822.3	18	50.2	21	198.3	12	5.1	5.1	19.7	29	1.1
FEDERATED DEPARTMENT STORES FD ⁽¹¹⁾	3775.0**	-10	17444.0	-4	13.0	NM	513.0	NM	0.3	NM	5.9	15	2.1
FOOT LOCKER Z ⁽¹¹⁾	1104.0	2	4480.0	5	33.0	14	111.0	-27	3.0	2.7	10.3	18	0.1
GAP GPS ⁽¹¹⁾	3333.4	-2	14337.3	11	-178.8	NM	298.1	-71	NM	5.5	9.8	19	0.1
GOODY'S FAMILY CLOTHING GDYS ⁽¹¹⁾	279.3	1	1229.7	-1	0.3	-83	-1.4	NM	0.1	0.6	-0.7	NM	-0.1
HOME DEPOT HD ⁽¹¹⁾	13289.0	15	50528.0	14	778.0	20	2799.0	4	5.9	5.6	16.1	11	1.1
INSIGHT ENTERPRISES N5IT	529.9	-3	2082.3	2	0.3	-98	33.9	-40	0.0	2.6	10.6	27	0.1
INTIMATE BRANDS IBI ⁽¹¹⁾	905.6	-4	5022.0	0	-10.7	NM	314.9	-36	NM	4.6	47.8	28	0.1

MY DAYS AS A

CORPORATE RAIDER



BY

✿ KENNY H. ✿

WHEN I DO DRUGS MY MOM AND DAD SPEND THEIR DAYS WORRYING INSTEAD OF WORKING. AND THAT'S GOT A BUNCH OF GUYS IN SUITS SOMEWHERE ALL STRESSED OUT. 'CAUSE IT MEANS KIDS LIKE ME ARE KINDA ROBBING COMPANIES BLIND. ***

I DIDN'T KNOW anything about business at first. I was just a kid who started smoking pot with his friends. That's all. But we got busted a lot for doing it at school and cutting class. And every time that happened, they called my mom at work.

Then she called my dad's office. And together they called my friends' parents – a bunch of times my dad even left work to look for me.

Other times they had to drive to school for talks with my teachers and missed all kinds of meetings and stuff at the office. My mom got behind on her projects. And dad freaked about reports he couldn't finish.

At home, they argued a lot about what they should do with me and finally ended up sending me to this guy like twice a week. Every time I saw him,

we'd talk for an hour. Then mom and dad started seeing him too, almost as much as I was. And when all those bills came, dad just looked at me and said I was lucky he had good insurance at his job.

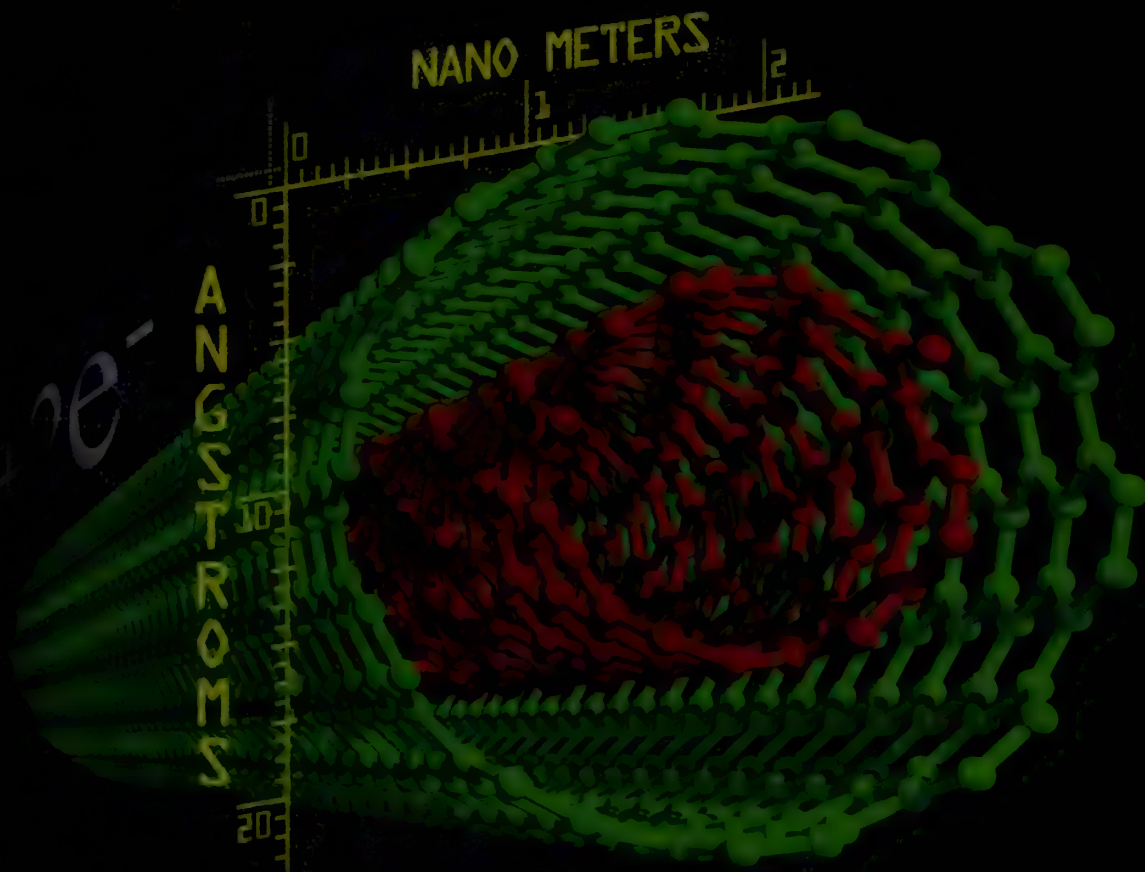
That was right about the time the guys in suits really started to get stressed. And if you ask me, they probably still are. 'Cause if I can do this, so can any other kid.

WHEN EMPLOYEES have children with substance abuse problems, it may also affect productivity and healthcare costs. But employers can make a difference. Provide parents in your workplace with free, teen drug prevention articles, brochures, posters and tools by visiting our Web site: **EMPLOYERS.**
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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETENTION COMMON EQUITY ENDING 12-31	PRICE/ EARNINGS RATIO 2-7	MOV EAR P SP
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
JO-ANN STORES JAS.A ⁽¹¹⁾	413.0	14	1568.5	9	-11.3	NM	-42.9	NM	NM	0.9	-20.2	NM	-2
KMART KM ⁽¹¹⁾	8019.0	-2	36910.0	1	-224.0	NM	-95.0	NM	NM	NM	-1.6	NM	-0
KOHL'S KSS ⁽¹¹⁾	1760.3	22	6987.5	26	100.2	31	440.3	40	5.7	5.3	17.3	50	1
LANDS' END LE ⁽¹¹⁾	376.1	4	1511.6	7	12.1	173	52.8	59	3.2	1.2	16.1	26	1
LIMITED LTD ⁽¹¹⁾	1906.5	-12	9747.4	-1	90.2	85	430.5	-15	4.7	2.3	17.7	17	0
LOWE'S LOW ⁽¹¹⁾	5454.5	21	21400.7	19	250.5	24	945.7	16	4.6	4.5	14.7	38	1
MAY DEPARTMENT STORES MAY ⁽¹¹⁾	3202.0**	-4	14532.0	3	55.0	-35	793.0	-7	1.7	2.6	20.9	14	2
MEN'S WEARHOUSE MW ⁽¹¹⁾	285.6	-6	1334.3	4	4.0	-77	65.2	-15	1.4	5.6	13.2	14	1
MICHAELS STORES MIK ⁽¹¹⁾	611.9	16	2438.2	16	18.8	20	80.9	5	3.1	3.0	10.7	28	1
NEIMAN MARCUS GROUP NMGA ⁽⁵⁾	681.1**	-10	2939.5	-2	23.0	-54	80.5	-45	3.4	0.0	8.3	20	0
NORDSTROM JWN ⁽¹¹⁾	1271.6**	-2	5793.0	4	10.5	NM	101.0	-29	0.8	NM	7.9	31	1
OFFICEMAX OMX ⁽¹¹⁾	1188.8	-9	4784.8	-6	-25.8	NM	-151.3	NM	NM	NM	-16.9	NM	-1
PAYLESS SHOESOURCE PSS ⁽¹¹⁾	697.1	-4	2971.5	4	13.3	-59	93.3	-26	1.9	4.5	18.9	13	4
PC CONNECTION PCCC	273.1	-21	1181.0	-19	1.4	-75	7.2	-77	0.5	1.6	4.9	37	0
PENNEY (J.C.) JCP ⁽¹¹⁾	7729.0	3	32035.0	0	31.0	NM	-304.0	NM	0.4	NM	-5.9	NM	-1
PEP BOYS-MANNY, MOE & JACK PBY ⁽¹¹⁾	551.3	-11	2222.9	-8	11.0	NM	33.7	NM	2.0	NM	8.5	21	0
PETSMART PETM ⁽¹¹⁾	598.6	11	2373.6	8	5.8	NM	-18.1	NM	1.0	NM	-6.2	NM	-0
ROSS STORES ROST ⁽¹¹⁾	739.3	16	2917.3	11	35.0	18	150.3	1	4.7	4.7	28.6	19	1
SAKS SKS ⁽¹¹⁾	1423.6**	-9	6282.1	-3	-23.8	NM	-14.8	NM	NM	NM	-0.7	NM	-0
SCHOOL SPECIALTY SCHS ⁽⁸⁾	269.7	12	764.9	14	19.3	10	23.7	23	7.1	5.4	8.3	21	1
SEARS, ROEBUCK S	12242.0	-1	41078.0	0	494.0	12	735.0	-45	4.0	3.6	12.0	23	2
SHERWIN-WILLIAMS SHW	1133.4	-1	5066.0	-3	45.4	NM	263.2	NM	4.0	NM	18.1	15	1
SHOPKO STORES SKO ⁽¹¹⁾	800.9	-2	3517.8	3	-5.2	NM	-53.9	NM	NM	NM	-8.2	NM	-1
SPORTS AUTHORITY TSA ⁽¹¹⁾	305.6	-8	1437.6	-4	-4.5	NM	9.6	NM	NM	NM	8.3	27	0
STAPLES SPLS ⁽¹¹⁾	2833.9	1	10930.0	7	91.3	8	59.5	-80	3.2	3.0	3.1	NM	0
TALBOTS TLB ⁽¹¹⁾	394.0**	-1	1652.4	10	36.6	5	127.5	31	9.3	8.8	23.7	17	1
TARGET TGT ⁽¹¹⁾	9354.0**	9	38975.0	10	185.0	-14	1263.0	2	2.0	2.5	17.6	30	1
TIFFANY TIF ⁽¹¹⁾	333.1**	-10	1617.2	-2	24.0	-34	175.5	-8	7.2	9.8	18.1	28	1
TJX TJX ⁽¹¹⁾	2741.8	11	10251.6	10	149.5	-6	520.3	-4	5.5	6.4	41.5	20	1
TOYS 'R' US TOY ⁽¹¹⁾	2178.0	-2	11059.0	-4	-44.0	NM	160.0	-59	NM	NM	4.9	32	0
VALUE CITY DEPARTMENT STORES VCD ⁽¹¹⁾	588.7	5	2331.3	12	-6.5	NM	-42.9	NM	NM	NM	-18.7	NM	-1
WAL-MART STORES WMT ⁽¹¹⁾	52738.0	15	210144.0	13	1481.0	2	6486.0	4	2.8	3.0	18.9	40	1
ZALE ZLC ⁽⁵⁾	405.4	9	2101.8	13	-3.7	NM	74.3	-33	NM	1.1	8.5	20	2
9 ELECTRICAL & ELECTRONICS													
INDUSTRY COMPOSITE	47100.3	-28	201383.6	-16	-5151.1	NM	-72520.7	NM	NM	6.2	-44.6	NM	-3.
(A) ELECTRICAL PRODUCTS													
GROUP COMPOSITE	7077.6	-13	29071.5	-7	391.5	-37	1556.9	-40	5.5	7.7	11.8	24	1.
ACQUIRY BRANDS AVI ⁽⁴⁾	481.7	-4	NA	NA	11.5	-15	NA	NA	2.4	2.7	NA	NA	1
AMERICAN POWER CONVERSION APOC	348.1	-15	1433.3	-3	30.9	-20	115.2	-30	8.9	9.4	9.4	22	0.
AMETEK AME	237.3	-8	1019.3	-1	11.5	-34	66.1	-4	4.8	6.7	20.2	15	1.
COOPER INDUSTRIES CBE	989.6	-11	4209.5	-6	62.6	-30	261.3	-27	6.3	8.1	13.0	12	2.
EMERSON ELECTRIC EMR ⁽³⁾	3294.8	-16	14854.9	-7	254.7	-29	929.1	-36	7.7	9.1	14.9	25	2.
GENLYTE GROUP GLYT	231.3	-7	985.2	-2	10.5	3	37.3	3	4.5	4.1	14.7	11	2.
HUBBELL HUBB	301.2	-13	1312.2	-8	-14.1	NM	48.3	-65	NM	8.2	6.6	36	0.
ROCKWELL INTERNATIONAL ROK ⁽³⁾	938.0	-16	4106.0	-12	29.0	-58	85.0	-74	3.1	6.2	5.4	39	0.
SMITH (A.O.) ADS	255.5	-6	1151.2	-8	-5.1	NM	-14.5	-65	NM	0.9	3.2	38	0.
(B) ELECTRONICS													
GROUP COMPOSITE	12766.5	-18	51553.3	-13	-1189.4	NM	-4766.7	NM	NM	NM	-15.7	NM	-1.0
AVAYA AV ⁽³⁾	1306.0	-27	6314.0	-18	-20.0	NM	-388.0	NM	NM	0.9	-91.8	NM	-1.
HARRIS HRS ⁽⁸⁾	451.5	-7	1902.7	-1	16.4	3	73.7	NM	3.6	3.3	6.6	29	1.
HUGHES ELECTRONICS GHR	2280.6	11	8262.0	13	-132.6	NM	-614.2	NM	NM	NM	-7.4	NM	-0.
L-3 COMMUNICATIONS HOLDINGS LLL	708.6	27	2347.4	23	44.6	43	115.5	40	6.3	5.6	9.5	34	2.
MOTOROLA MOT	7324.0	-27	30004.0	-20	-1237.0	NM	-3937.0	NM	NM	1.3	-28.8	NM	-1.
QUALCOMM QCOM ⁽³⁾	698.6	7	2723.2	0	139.2	NM	-16.7	NM	19.9	NM	-0.7	NM	-0.
(C) INSTRUMENTS													
GROUP COMPOSITE	5251.7	-23	23174.4	0	-298.7	NM	713.3	-60	NM	9.7	5.3	74	0.4
ACTERNA ACTR ⁽⁸⁾	249.8	-33	1250.5	13	-74.0	NM	-238.4	NM	NM	NM	NM	NM	-1.
AGILENT TECHNOLOGIES A ⁽²⁾	1606.0	-47	8396.0	-10	-449.0	NM	-406.0	NM	NM	10.0	-7.2	NM	-0.
APOGENT TECHNOLOGIES AOT ⁽³⁾	241.2	9	1004.9	14	30.0	11	117.7	26	12.4	12.3	14.0	23	1.
APPLIED BIOSYSTEMS GROUP ABI ⁽⁸⁾	411.1	0	1622.6	6	49.0	-15	186.5	-15	11.9	14.1	17.5	25	0.
BECKMAN COULTER BCO	578.3	10	1984.0	5	38.3	12	141.5	13	8.4	8.2	27.3	21	2.
BIO-RAD LABORATORIES BIOA	232.4	31	817.5	13	17.0	72	44.2	39	7.3	5.5	16.2	17	3.
DANAHER DHR	918.9	-11	3782.4	0	33.1	-62	297.7	-8	3.6	8.5	13.5	30	2.
KLA-TENCOR KLA ⁽⁶⁾	404.1	-19	2127.2	20	49.0	-37	401.8	48	12.1	15.5	22.1	26	2.
PERKINELMER PKI	361.2	-4	1330.1	0	55.2	NM	-0.6	NM	NM	7.9	-0.1	NM	-0.
WATERS WAT	248.7	10	859.2	8	53.1	5	169.0	8	21.3	22.4	26.5	27	1.

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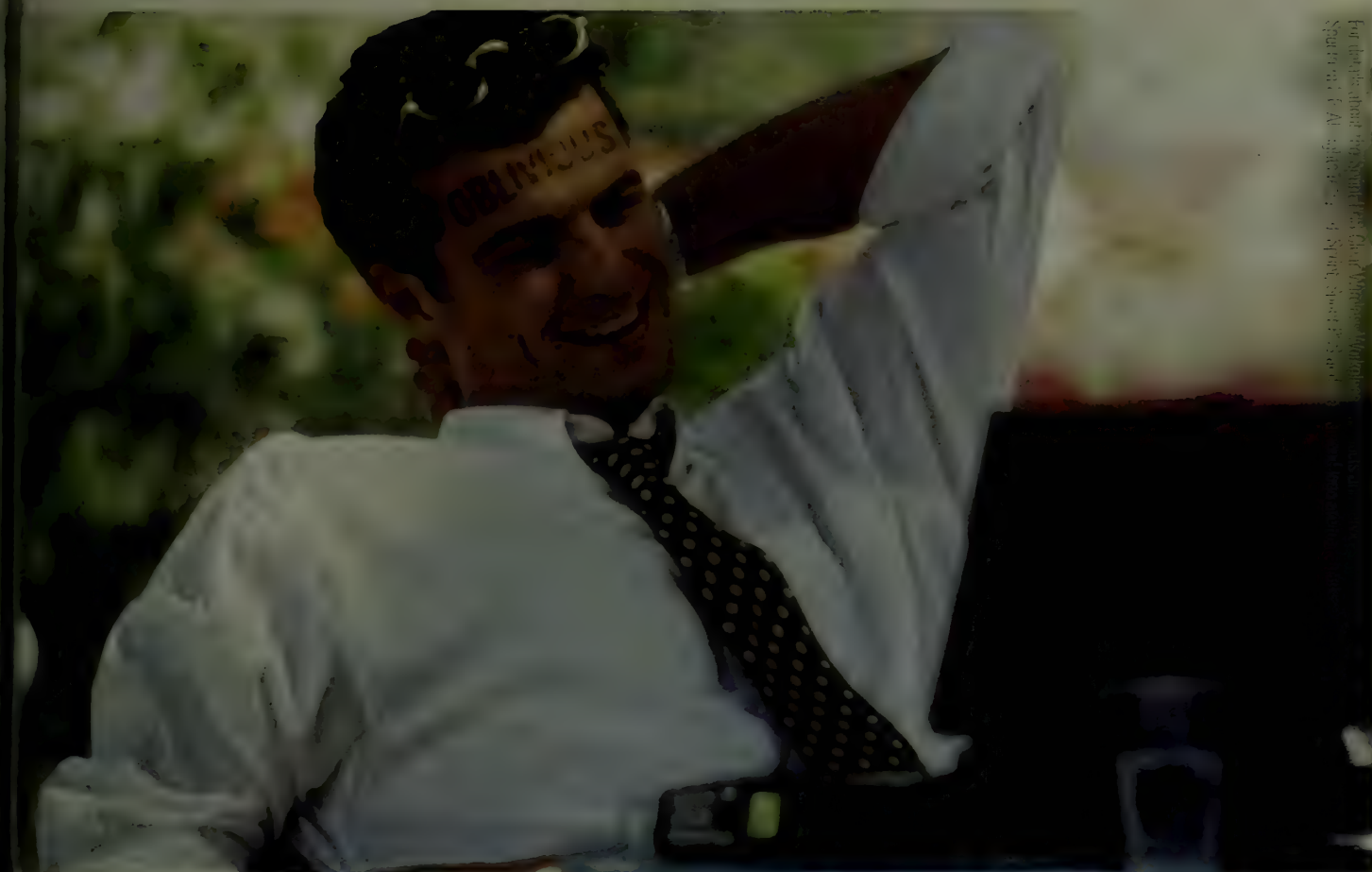
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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 12-31	PRICE/ EARNINGS RATIO 2-7	1-MON. % CHG. PER SHARE
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
(D) SEMICONDUCTORS & OTHER COMPONENTS													
GROUP COMPOSITE	22004.5	-37	97584.3	-23	-4054.6	NM	-70024.2	NM	NM	8.7	-66.6	NM	-4.3
ADVANCED MICRO DEVICES AMD	951.9	-19	3891.8	-16	-15.8	NM	-60.6	NM	NM	15.1	-1.7	NM	-0.1
AGERE SYSTEMS AGR.A (3)	537.0	-61	3255.0	-36	-375.0	NM	-4987.0	NM	NM	0.0	NM	NM	-3
AMKOR TECHNOLOGY AMKR	352.4	-45	1517.9	-36	-136.6	NM	-450.9	NM	NM	6.4	-44.7	NM	-2.8
AMPHENOL APH	260.4	-30	1103.8	-19	16.0	-51	83.7	-22	6.2	8.8	80.5	22	1.4
ANALOG DEVICES ADI (2)	423.3	-47	2276.9	-12	24.2	-88	356.4	-41	5.7	24.8	12.5	42	0.1
ATMEL ATML	284.6	-50	1472.3	-27	-31.6	NM	-418.3	NM	NM	15.0	-28.1	NM	-0.8
AVX AVX (9)	304.3	-57	1575.8	-37	-6.5	NM	119.7	-77	NM	23.4	8.0	28	0.1
BENCHMARK ELECTRONICS BHE	269.6	-45	1277.0	-25	-0.3	NM	-54.3	NM	NM	1.7	-15.4	NM	-2.1
BROADCOM BCM	226.8	-33	961.8	-12	-329.6	NM	-2742.0	NM	NM	NM	-85.5	NM	-10
CONEXANT SYSTEMS CNXT (3)	229.5	-44	881.7	-56	-204.5	NM	-1450.2	NM	NM	NM	-91.8	NM	-5.8
FAIRCHILD SEMICONDUCTOR INTL FCS	324.6	-31	1407.7	-21	-16.2	NM	-41.7	NM	NM	20.0	-5.2	NM	-0.4
INTEL INTC	6983.0	-20	26539.0	-21	504.0	-77	1291.0	-88	7.2	25.2	2.6	NM	0.1
JABIL CIRCUIT JBL (4)	884.6	-22	4086.3	2	8.4	-82	79.2	-53	0.9	4.2	5.6	80	0.4
JDS UNIPHASE JDSU (6)	286.1	-69	2135.9	-19	-2130.5	NM	-57564.8	NM	NM	NM	NM	NM	-48.5
LSI LOGIC LSI	405.8	-46	1784.9	-35	-250.1	NM	-992.0	NM	NM	8.2	-40.0	NM	-2.8
MANUFACTURERS SERVICES MSV	271.5	-57	1522.0	-13	-24.1	NM	-95.1	NM	NM	0.8	-83.7	NM	-2.8
MAXIM INTEGRATED PRODUCTS MXIM (6)	247.1	-44	1202.5	-26	62.6	-49	217.5	-51	25.3	27.9	12.0	83	0.6
MICRON TECHNOLOGY MU (4)	423.9	-73	2788.2	-58	-265.9	NM	-1146.6	NM	NM	22.9	-16.6	NM	-1.9
MOLEX MOLX (6)	416.5	-34	1957.2	-20	4.3	-94	101.0	-60	1.0	10.8	5.3	50	0.5
NATIONAL SEMICONDUCTOR NSM (7)	366.5	-38	1582.6	-34	-46.6	NM	-106.4	NM	NM	17.9	-6.2	NM	-0.6
NVIDIA NVDA (11)	370.2	87	1089.7	69	44.7	59	135.2	52	12.1	14.2	22.1	74	0.8
ON SEMICONDUCTOR ONNM	266.9	-46	1214.6	-41	-450.9	NM	-715.0	NM	NM	3.6	NM	NM	-4.2
SANMINA-SCI SANM (3)	1130.5	-24	3698.9	-24	-45.2	NM	-120.7	NM	NM	7.8	-2.0	NM	-0.3
SOLETRON SLR (4)	3152.2	-45	16149.0	-5	-50.5	NM	-364.6	NM	NM	3.3	-7.1	NM	-0.5
TEXAS INSTRUMENTS TXN	1786.0	-41	8201.0	-31	-116.0	NM	-201.0	NM	NM	21.9	-1.7	NM	-0.1
VIASYSTEMS GROUP VG	240.1	-47	1206.5	-25	-178.8	NM	-587.0	NM	NM	3.0	NM	NM	-4.2
VISHAY INTERTECHNOLOGY VSH	381.2	-41	1655.3	-33	-53.6	NM	0.5	NM	NM	21.9	0.0	NM	0.0
XILINX XLNX (9)	228.1	-49	1149.1	-26	9.7	NM	-310.0	NM	4.2	NM	-16.7	NM	-0.9
10 FOOD													
INDUSTRY COMPOSITE	109460.2	11	416418.6	9	1092.2	2	12012.8	4	2.8	3.1	15.2	24	1.2
(A) FOOD DISTRIBUTION													
GROUP COMPOSITE	13500.7	-2	55934.0	3	238.0	9	805.0	-7	1.8	1.6	14.8	31	0.8
ANDERSONS ANDE	307.0	-5	1584.6	2	4.3	-2	9.0	-10	1.4	1.4	9.5	8	1.2
INTERNATIONAL MULTIFOODS IMC (10)	739.2	12	2759.7	13	-0.1	NM	7.4	-71	NM	1.3	2.8	54	0.3
PERFORMANCE FOOD GROUP PFGC	920.1	-36	3237.2	24	13.5	70	43.6	-62	1.5	1.2	7.1	33	1.1
SPARTAN STORES SRTN (9)	1082.8	-6	3502.0	8	0.0	NM	18.4	-6	0.0	0.6	7.8	8	0.9
SUPERVALU SVU (10)	4610.3	-15	21743.9	-6	59.0	24	77.8	-68	1.3	0.9	4.1	42	0.5
SYSCO SY (6)	5591.0	6	22553.4	9	158.5	14	636.0	20	2.8	2.6	29.2	30	0.9
UNITED NATURAL FOODS UNFI (5)	280.3	-15	1053.0	13	2.6	-20	12.7	316	0.9	1.3	9.2	35	0.6
(B) FOOD PROCESSING													
GROUP COMPOSITE	52215.0	22	189815.5	16	2253.4	5	8622.4	6	4.3	5.0	15.7	23	1.2
ARCHER DANIELS MIDLAND ADM (6)	5554.2	12	21534.0	14	150.0	20	430.9	9	2.7	2.5	6.7	21	0.6
CAMPBELL SOUP CPB (5)	1729.0	9	6563.0	5	171.0	-16	616.0	-10	9.9	12.9	NM	18	1.5
CONAGRA FOODS CAG (7)	7363.6	2	27807.0	6	231.6	-18	659.2	25	3.1	3.9	16.0	19	1.2
CORN PRODUCTS INTERNATIONAL CPO	478.2	2	1987.4	1	9.3	-24	56.7	19	2.0	2.6	6.6	18	1.6
DEL MONTE FOODS DLM (6)	391.3	9	1436.6	11	18.9	122	38.7	-67	4.8	2.4	100.3	12	0.7
DOLE FOOD DOL	982.5	-2	4449.3	-1	4.1	NM	-37.1	NM	0.4	NM	-3.8	NM	-0.6
FLOWERS FOODS FLO	407.2	3	1629.0	4	1.4	NM	-12.1	NM	0.3	NM	-1.9	NM	-0.4
GENERAL MILLS GIS (7)	2342.6	24	7621.4	11	130.8	-35	625.4	0	5.6	10.7	17.6	21	2.0
HEINZ (H.J.) HNZ (8)	2565.2	12	9713.1	4	208.2	10	508.7	-23	8.1	8.3	37.1	28	1.4
HERSHEY FOODS HSY	1273.9	7	4557.2	8	45.0	NM	207.2	-38	NM	9.7	18.1	47	1.5
HORMEL FOODS HRL (2)	1118.7	11	4124.1	12	68.8	13	182.4	7	6.2	6.1	18.3	20	1.3
INTERSTATE BAKERIES IBC (7)	829.3	2	3517.0	-1	21.2	87	53.9	-19	2.6	1.4	13.1	24	1.0
KELLOGG K	2213.0	-42	9953.3	27	124.6	34	7482.0	-18	5.6	6.0	55.3	26	1.1
KRAFT FOODS KFT	8760.0	27	33473.0	28	548.0	32	1992.0	-6	6.3	6.0	8.0	32	1.1
LANCASTER COLONY LANC (6)	311.9	0	1100.7	1	17.4	-42	76.9	-19	5.6	9.6	16.5	16	2.0
MCCORMICK MKC (1)	701.0	3	2372.4	12	59.1	3	146.6	7	8.4	8.5	31.7	22	2.0
PILGRIM'S PRIDE CHX (3)	656.0	70	2484.7	62	13.0	2	42.3	-16	2.0	3.3	10.8	12	1.0
RALCORP HOLDINGS RAH (3)	325.1	13	1215.7	32	12.8	47	44.0	17	3.9	3.0	11.3	17	1.4
SARA LEE SLE (6)	4990.0	5	18043.0	1	160.0	6	1616.0	74	3.2	3.2	118.9	11	1.9
SENECA FOODS SENE (9)	236.9	-5	653.7	-2	2.3	NM	-0.8	NM	1.0	NM	-0.8	NM	-0.1
SMITHFIELD FOODS SFD (8)	1670.3	17	6354.4	13	60.5	36	251.8	86	3.6	3.1	19.0	11	2.3
STARBUCKS SBUX (3)	805.3	21	2786.9	20	65.4	40	200.6	84	8.5	7.3	13.4	42	0.5
TYSON FOODS TSN (2)	5865.0	232	14807.0	102	127.0	370	188.1	55	2.2	1.5	5.4	20	0.6
WRIGLEY (W.M.) JR. WMY	646.6	20	2429.6	13	89.9	15	363.0	10	13.9	14.5	28.4	34	1.6



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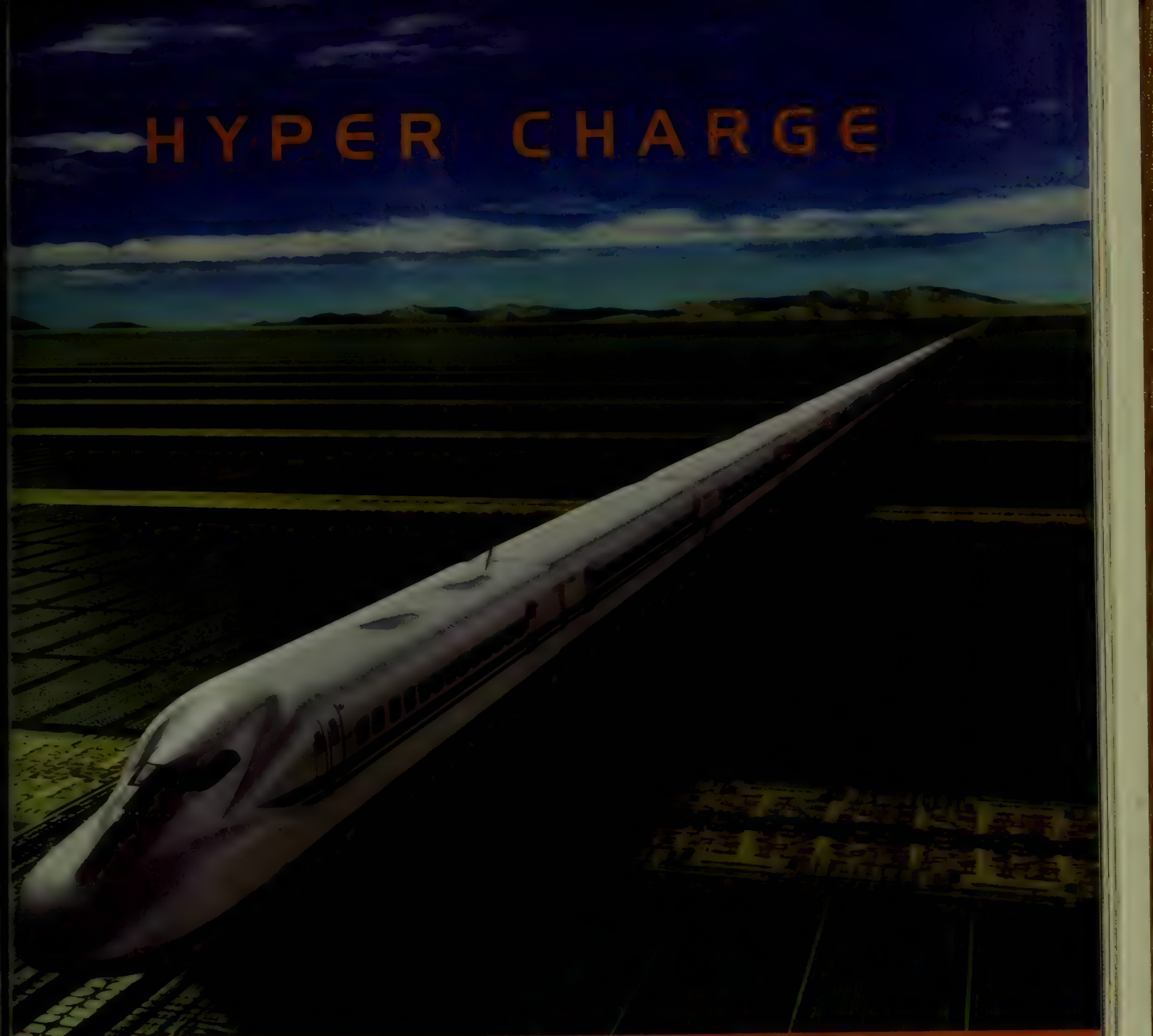


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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON EQUITY 12 MONTHS ENDING 12-31	PRICE/EARNINGS RATIO 2-7	1-MON EARN. PER SHR.
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
(C) FOOD RETAILING													
GROUP COMPOSITE	43744.5	4	170669.0	4	500.8	-10	2585.4	3	1.4	1.6	13.8	22	1.1
ALBERTSON'S ABS ⁽¹¹⁾	9363.0	4	37815.0	2	176.0	2	431.0	-47	1.9	1.9	7.5	27	1
FOODARAMA FSM ⁽²⁾	249.7	14	945.3	5	0.8	22	3.9	55	0.3	0.3	10.2	10	3
GREAT ATLANTIC & PACIFIC TEA GAP ⁽¹⁰⁾	2525.4	4	11016.0	5	-92.5	NM	-113.6	NM	NM	NM	-16.4	NM	-2
INGLES MARKETS IMKTA ⁽³⁾	499.4**	-1	1948.2	0	4.6	2	18.0	-13	0.9	0.9	7.6	15	0
KROGER KR ⁽¹¹⁾	11382.0	4	50661.0	7	133.0	-34	1060.0	42	1.2	1.8	32.6	16	1
PATHMARK STORES PTMK ⁽¹¹⁾	986.0	5	4016.8	7	-60.9	NM	-232.0	NM	NM	NM	-57.5	NM	-7
PENN TRAFFIC PNFT ⁽¹¹⁾	598.8**	2	2481.0	4	-26.4	NM	-96.8	NM	NM	NM	-52.5	NM	-4
RUDDICK RDK ⁽³⁾	653.2	-9	2679.0	-2	10.5	-6	-1.4	NM	1.6	1.6	-0.3	NM	-0
SAFeway SWY	10686.4	7	34301.0	7	384.1	28	1284.4	13	3.6	3.0	20.5	17	2
7-ELEVEN SE	2329.5**	1	9894.1	5	17.1	25	93.6	-12	0.7	0.5	61.4	12	0
WEIS MARKETS WMK	507.9	-7	1988.2	-4	12.5	-18	50.1	-32	2.5	2.8	5.6	18	1
WINN-DIXIE STORES WIN ⁽⁶⁾	3963.2	0	12923.4	-2	42.1	246	88.2	NM	1.1	0.3	11.0	21	0
11													
INDUSTRY COMPOSITE	113003.2	-23	512710.7	-3	787.2	-93	32399.4	-16	0.7	8.0	16.4	17	2.4
(A) COAL, OIL & GAS													
GROUP COMPOSITE	100782.1	-26	464155.9	-5	65.1	NM	29170.0	-20	0.1	8.3	18.2	16	2.6
AMERADA HESS AHC	2881.0	-22	13413.0	12	54.0	-84	914.0	-11	1.9	9.2	18.6	6	10.2
ANADARKO PETROLEUM APC	1379.0	-41	8369.0	52	109.0	-76	-176.0	NM	7.9	19.4	12.4	NM	-0.2
APACHE APA	534.1	-27	2790.7	22	78.6	-69	723.4	0	14.7	35.1	17.2	10	4.5
ARCH COAL ACI	373.5	5	1462.5	5	8.4	-13	7.2	NM	2.3	2.8	1.3	NM	0
ASHLAND ASH ⁽³⁾ †	1831.0	-3	7732.0	-4	38.0	-36	386.0	25	2.1	3.1	17.1	8	5.4
BURLINGTON RESOURCES BR	611.0	-39	3326.0	5	-79.0	NM	558.0	-17	NM	30.4	15.1	13	2.8
CHEVRONTXACO CVX	19606.0	-35	97863.0	-11	-2375.0	NM	3931.0	-49	NM	6.8	17.1	22	3.6
CONOCO EOC	8491.0**	-18	39539.0	1	147.0	-73	1596.0	-16	1.7	5.3	24.2	11	2.5
CONSOL ENERGY CNX ⁽⁶⁾	539.6**	-5	2340.8	5	12.6	-57	151.2	52	2.3	5.2	55.7	11	1.9
DEVON ENERGY DVM	740.0**	-13	3075.0	10	-518.0	NM	54.0	-93	NM	36.1	1.2	NM	0.1
EOG RESOURCES EOG	233.9	-53	1556.2	5	-24.8	NM	398.6	0	NM	32.1	25.9	10	3.3
EXXON MOBIL XOM	41394.0**	-29	191158.0	-9	2680.0	-45	15105.0	-6	6.5	8.4	20.5	18	2.1
HOLLY HOC ⁽⁵⁾	257.9	-21	1074.1	-2	20.2	-1	73.3	156	7.8	6.3	33.3	4	4.7
KERR-MCGEE KMG	757.5	-32	3638.0	-12	-49.6	NM	506.7	-40	NM	25.3	16.0	11	4.9
MURPHY OIL MUR	849.4	-33	4478.5	-3	28.8	-69	330.9	5	3.4	7.3	22.1	11	7.2
OCCIDENTAL PETROLEUM OXY	2380.0	-40	13985.0	3	-242.0	NM	1186.0	-24	NM	8.4	20.2	8	3.1
PEABODY ENERGY BTU ⁽⁹⁾	687.2**	8	2711.8	3	5.3	NM	143.7	20	0.8	NM	13.9	6	3.5
PENNZOIL-QUAKER STATE PZL	545.9	-7	2313.2	-5	-20.0	NM	-10.5	NM	NM	NM	-1.2	NM	-0.1
PHILLIPS PETROLEUM P	8799.0	55	24050.0	15	162.0	-78	1643.0	-12	1.8	13.1	11.4	10	5.5
SUNOCO SUN	2488.0	-27	12322.0	-4	4.0	-97	398.0	-3	0.2	4.5	27.2	8	4.6
TESORO PETROLEUM TSO	1278.9**	-11	5217.8	1	4.0	-84	88.0	20	0.3	1.7	14.7	7	2.1
UNOCAL UCL	1263.0**	-55	6752.0	-27	-30.0	NM	599.0	-17	NM	6.2	18.7	14	2.4
VALERO ENERGY VLO	2861.2	-31	14988.3	2	51.6	-45	563.6	55	1.8	2.3	27.6	5	8.8
(B) PETROLEUM SERVICES													
GROUP COMPOSITE	12221.1	16	48554.8	28	722.1	57	3229.4	55	5.9	4.4	8.3	23	1.3
BJ SERVICES BJS ⁽³⁾	510.1	4	2253.9	33	66.9	5	352.7	119	13.1	13.0	25.7	13	2.1
COOPER CAMERON CAM	407.0**	17	1563.7	13	29.9	NM	98.3	255	7.3	NM	10.7	22	1.7
FMC TECHNOLOGIES FTI	546.4	13	1927.9	3	21.4	-8	39.4	-42	3.9	4.8	10.1	27	0.6
GLOBAL SANTAFE GSF	384.4	16	1349.4	30	11.7	-71	198.8	75	3.0	12.3	17.9	17	1.5
HALLIBURTON HAL	3172.0**	-1	13046.0	5	141.0	NM	551.0	193	4.4	NM	12.0	10	1.2
HARBORS INDUSTRIES HBR	428.9	4	2121.2	10	52.4	-5	347.8	157	12.2	13.3	10.5	13	2.1
NOBLE AFFILIATES NBL	299.9	-34	1576.8	14	-27.5	NM	133.6	-30	NM	15.6	13.2	14	2.3
NOBLE DRILLING NE	260.5	5	1002.3	14	63.5	22	263.9	50	24.4	21.5	14.8	15	1.9
SCHLUMBERGER SLB	3577.4	33	13745.8	43	185.0	-22	522.2	-29	5.2	8.8	6.2	11	0.9
SMITH INTERNATIONAL SII	903.8	19	3551.2	29	38.2	47	152.1	100	4.2	3.4	16.6	17	3.0
TRANSOCEAN SEDCO FOREX RIG	747.6	137	2820.1	129	57.9	NM	271.9	154	7.7	NM	2.5	10	0.6
VARCO INTERNATIONAL VRC	362.2	47	1267.8	46	27.2	93	83.0	294	7.5	5.7	10.0	15	0.8
WEATHERFORD INTERNATIONAL WFT	620.9	16	2328.7	28	54.5	NM	214.7	NM	5.5	NM	12.6	11	1.7
12													
INDUSTRY COMPOSITE	156016.2	18	573247.9	16	8957.2	42	44645.6	21	5.7	4.0	22.5	34	1.3
(A) DRUG DISTRIBUTION													
GROUP COMPOSITE	55441.2	31	192409.0	22	427.4	5	1821.5	115	0.8	1.0	7.6	57	0.6
AMERISOURCEBERGEN ABC ⁽³⁾	11068.8	235	23952.9	95	71.5	173	169.1	53	0.6	0.8	5.7	27	2.2
CARDINAL HEALTH CAH ⁽⁶⁾	13092.1	10	49846.6	16	283.3	25	975.9	20	2.2	1.9	16.6	20	2.1
CVS CVS	5950.5	5	22241.4	11	-130.2	NM	413.2	-45	NM	3.8	9.3	27	1.0
D&K HEALTHCARE RESOURCES DKWD ⁽⁶⁾	591.7	67	2060.6	37	4.6	161	14.1	73	0.3	0.5	9.5	25	2.3
LONGS DRUG STORES LDG ⁽¹¹⁾	1017.4	1	4197.9	5	2.5	-67	33.4	-45	0.3	0.3	4.8	25	0.8
McKESSON MCK ⁽⁹⁾	13196.7**	20	48419.0	21	108.8	NM	117.7	164	0.8	0.1	3.1	100	0.4
NU SKIN ENTERPRISES NUS	232.6	4	885.6	1	13.6	-16	50.3	-18	5.9	7.2	13.2	13	0.6

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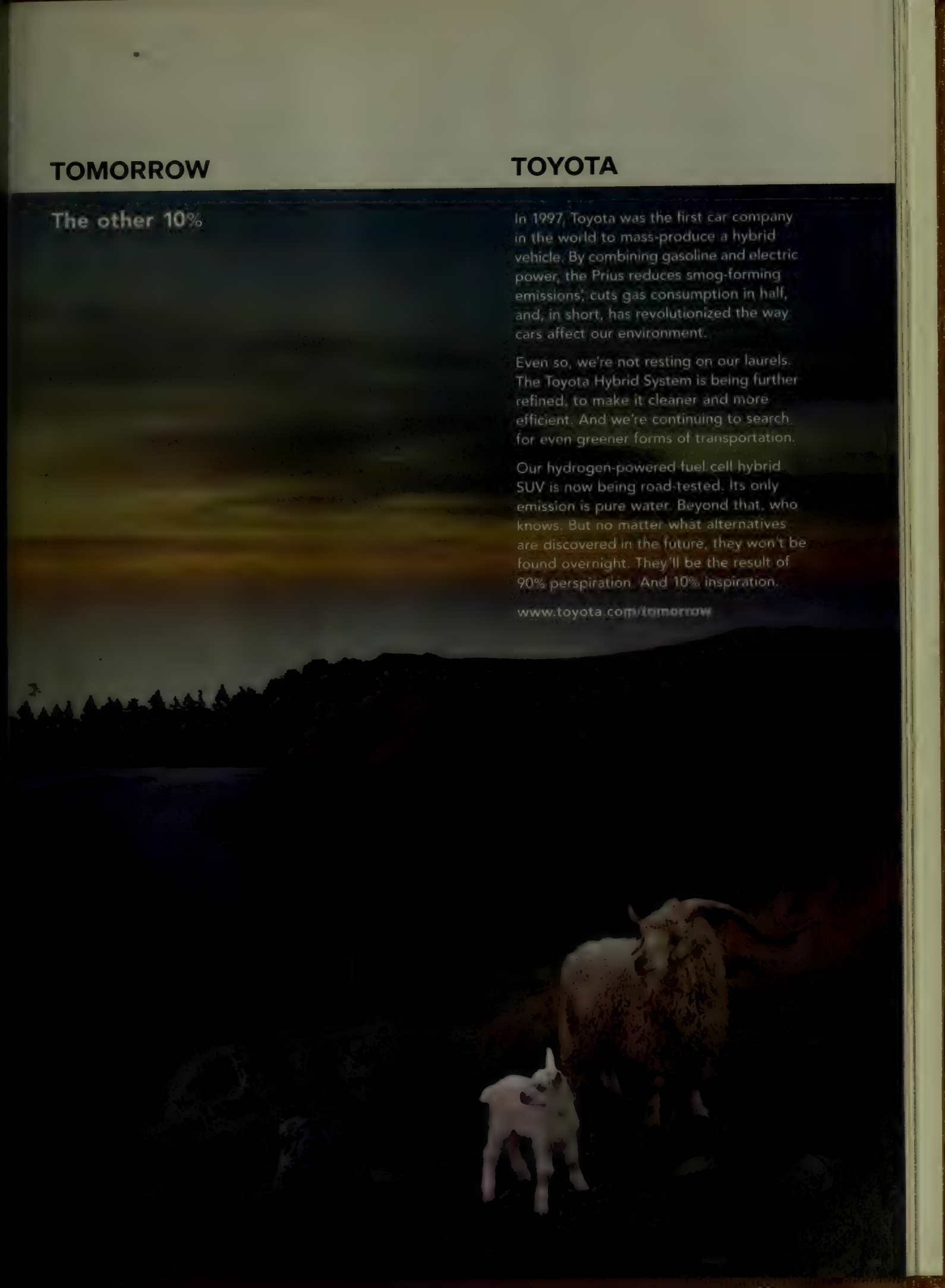


COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 12-31	PRICE- EARNINGS RATIO 2-7	12 MONTHS EARNINGS PER SHARE
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
E AID RAD ⁽¹⁰⁾	3732.1	5	15236.8	10	-112.8	NM	-865.3	NM	NM	NM	NM	NM	-2.22
LGREEN WAG ⁽⁴⁾	6559.4	17	25568.2	16	185.9	17	913.1	13	2.8	2.8	16.8	42	0.89
DRUGS & RESEARCH													
GROUP COMPOSITE	48621.5	11	180879.1	12	5890.6	81	30450.1	22	12.1	7.4	29.4	32	1.47
JOINT LABORATORIES ABT ⁽¹⁾	4445.1	20	16285.2	18	613.6	-19	1550.4	-44	13.8	20.3	17.9	56	0.99
BERGAN AGN	463.7	11	1745.5	7	84.1	29	226.7	5	18.1	15.5	23.2	39	1.69
BERGAN HOME PRODUCTS AHP	3726.7	7	14128.5	7	822.7	NM	2285.3	NM	22.1	NM	72.2	37	1.72
BEN AMGN	1124.3	10	4015.7	11	163.0	-23	1119.7	-2	14.5	22.2	21.5	54	1.03
BIR LABORATORIES BRL ⁽⁶⁾	366.1	146	996.4	94	42.3	151	150.0	234	11.5	11.3	26.7	19	3.40
BGEN BGEN	280.5	14	1043.4	13	58.9	-18	272.7	-18	21.0	29.3	20.2	29	1.78
BISTOL-MYERS SQUIBB BMY	5282.0	10	19423.0	7	-1049.0	NM	2527.0	-38	NM	22.3	25.4	33	1.29
IRON CHIR ⁽¹⁾	292.5	8	1056.1	19	44.7	NM	174.8	985	15.3	NM	9.0	44	0.90
NEST LABORATORIES FRX ⁽⁹⁾	403.1**	30	1454.1	31	87.4	33	310.6	79	21.7	21.3	22.1	47	1.68
NENTECH DNA	569.4**	23	2081.7	26	42.1	195	155.9	NM	7.4	3.1	2.6	NM	0.29
MUNEX IMNX	277.7	11	986.8	15	41.6	-15	170.0	10	15.0	19.6	8.2	93	0.30
LYELL LLY	2828.9	-5	11542.5	5	588.2	-23	2809.4	-8	20.8	25.8	38.1	23	2.58
IMMUNE MEDI	292.7	23	618.7	14	98.5	24	149.0	3	33.7	33.4	14.3	57	0.68
IRK MKR	12558.0	10	47715.7	18	1860.9	5	7281.8	7	14.8	15.4	47.4	19	3.14
LAN LABORATORIES MYL ⁽⁹⁾	297.2	33	1070.1	32	78.2	108	235.0	490	26.3	16.9	17.7	17	1.85
RRIGO PRGO ⁽⁶⁾	228.7	21	817.6	14	16.6	NM	46.0	376	7.2	0.4	11.3	18	0.61
ZER PFE	9030.0	12	32259.0	10	1957.0	39	7752.0	108	21.7	17.5	41.0	33	1.22
ASMACIA PHA	3684.0	10	13837.0	11	197.0	-20	1291.0	61	5.3	7.4	13.5	59	0.97
HEMING-PLOUGH EGP	2471.0	2	9802.0	0	143.0	-75	1943.0	-20	5.8	23.6	27.0	24	1.32
HEALTH-CARE SERVICES													
GROUP COMPOSITE	33483.3	13	129044.0	19	920.7	28	3145.7	56	2.7	2.4	12.0	36	1.11
VANCEPCS ADVP ⁽⁹⁾	3365.9	15	12659.8	178	32.7	386	89.5	268	1.0	0.2	10.9	29	1.02
ITHM ATI	2662.2	12	10419.7	19	87.7	21	342.2	51	3.3	3.0	16.6	17	3.30
VERLY ENTERPRISES BEV	679.5	1	2709.9	11	-266.6	NM	-301.3	NM	NM	NM	-53.8	NM	-2.90
REMARK RX CMX	1486.2	24	5614.0	27	60.5	71	190.5	82	4.1	3.0	NM	24	0.73
VENTRY HEALTH CARE CVH	814.5	13	3147.2	21	22.9	9	83.5	36	2.8	2.9	12.1	19	1.23
PRESS SCRIPTS ESRX	2609.6	34	9328.8	35	34.2	71	125.1	NM	1.3	1.0	15.0	31	1.56
NEHIS HEALTH VENTURES GHVI ⁽³⁾	669.5	5	2610.4	5	16.2	NM	-1194.7	NM	2.4	NM	NM	NM	-25.22
IA HCA	4538.0	9	17953.0	11	226.0	976	1068.0	345	5.0	0.5	21.7	21	1.98
HEALTH MANAGEMENT ASSOCIATES HMA ⁽³⁾	495.8	14	1941.4	18	50.5	26	205.3	18	10.2	9.3	16.9	24	0.80
IMANA HUM	2622.7**	1	10194.9	-4	35.1	32	117.2	30	1.3	1.0	8.0	19	0.70
WORED HEALTHCARE WIND	789.6	5	3081.4	7	16.1	NM	96.5	NM	2.0	NM	16.3	11	3.28
WONOR CARE HON	704.9	13	2694.1	13	-2.7	NM	83.7	114	NM	3.7	7.9	24	0.81
FORD HEALTH PLANS OHP	1120.9**	5	4421.2	5	94.3	-12	322.4	13	8.4	10.3	69.6	12	3.21
BEST DIAGNOSTICS DGX	910.4	9	3627.7	6	50.9	80	183.9	75	5.6	3.4	13.8	36	1.88
LECT MEDICAL SLMC	260.5	23	959.0	19	18.3	371	38.4	221	7.0	1.8	15.3	17	0.81
LEA HEALTH SERVICES SIE	339.1**	13	1291.5	11	5.7	45	17.5	NM	1.7	1.3	4.3	16	0.61
NET HEALTHCARE THC ⁽⁷⁾	3394.0	16	12936.0	12	192.0	10	765.0	13	5.7	6.0	14.4	28	2.30
NITEHEALTH GROUP UNH	6020.0**	11	23454.0	11	247.0	18	913.0	24	4.1	3.9	23.5	27	2.79
PHARMACEUTICALS													
GROUP COMPOSITE	18470.2	13	70915.7	10	1718.5	-11	9228.3	1	9.3	11.8	20.4	37	1.34
ARD (C.R.) BCR	302.8	5	1181.3	5	39.3	373	143.2	34	13.0	3.0	19.8	19	2.75
ROUCH & LOBS BOL	452.0	-3	1711.9	-3	13.1	NM	42.0	-49	2.9	NM	4.3	47	0.78
AXTER INTERNATIONAL BAX	2136.0	11	7663.0	11	-75.0	NM	664.0	-10	NM	14.0	18.6	50	1.09
ECTON, DICKINSON BDX ⁽³⁾	944.9	9	3828.9	5	99.7	35	464.4	19	10.5	8.5	20.1	21	1.72
OMET BMET ⁽⁷⁾	289.4	18	1116.6	16	61.5	19	214.8	11	21.2	21.2	17.2	40	0.79
OSTON SCIENTIFIC BSK	677.0	5	2670.0	12	65.0	11	-54.0	NM	9.6	9.4	-2.9	NM	-0.13
ENTSPY INTERNATIONAL XRAY	375.3	50	1129.1	27	33.8	10	121.5	20	9.0	13.2	19.9	21	1.54
INDANT GDT	718.7	11	2707.6	6	135.1	NM	484.0	29	18.8	1.3	34.7	30	1.58
IVACARE IVC	261.6	-3	1053.6	1	-11.8	NM	35.2	-41	NM	7.0	9.2	29	1.11
IMMUNON & JOHNSON JNJ	8403.0	15	33004.0	11	1105.0	18	5668.0	14	13.2	12.8	23.9	31	1.84
EDTRONIC MDT ⁽⁸⁾	1571.2	15	5906.4	10	66.7	-78	821.0	-30	4.2	22.7	14.1	71	0.67
OWENS & MINOR OMI	968.7	5	3815.0	5	11.3	15	30.1	-9	1.2	1.1	12.7	22	0.85
T. WIDE MEDICAL STI	348.2	15	1347.4	14	50.3	22	172.6	34	14.4	13.9	14.6	40	1.93
TRYKER SYR	709.8	16	2602.3	14	81.4	22	271.8	23	11.5	10.9	25.7	44	1.34
IMMER HOLDINGS ZMH	311.6	13	1178.6	13	43.2	-9	149.8	-15	13.9	17.3	190.3	44	0.77
HOUSING & REAL ESTATE													
INDUSTRY COMPOSITE	28852.0	13	105369.3	11	1840.1	95	6171.1	25	5.4	3.7	12.6	15	2.17
BUILDING MATERIALS													
GROUP COMPOSITE	10707.7	1	44306.7	-1	271.6	NM	1538.0	25	2.5	NM	14.6	19	1.76
AMERICAN STANDARD ASD	1750.0	-1	7465.0	-2	20.0	-66	295.0	-6	1.1	3.3	NM	15	4.04
AL-TILE INTERNATIONAL DTL	250.8	0	1028.8	5	21.9	-17	78.9	-22	8.7	11.4	27.1	17	1.35
HUGHES SUPPLY HUG ⁽¹¹⁾	790.0	-8	3113.2	-5	17.7	-6	29.7	-56	2.2	2.2	5.0	23	1.27
AFARGE NORTH AMERICA LAF	808.7	24	3323.0	19	82.0	39	234.1	-9	10.1	9.1	12.0	12	3.21

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COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE- EARNINGS RATIO	1. MONT. EARN. PER SHA.
	4TH QUARTER END \$ MIL.	CHANGE FROM 2000 %	12 MONTHS END \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER END \$ MIL.	CHANGE FROM 2000 %	12 MONTHS END \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %	12 MONTHS ENDING 12-31		
LENNOX INTERNATIONAL LI	728.5	-7	3119.7	-4	-40.3	NM	-42.4	NM	NM	1.1	-6.5	NM	-0.7
MARTIN MARIETTA MATERIALS MLM	440.1	22	1718.1	13	25.1	22	105.4	-6	5.7	5.7	10.3	13	2.0
DWENS CORNING CWC	1170.0	5	4760.0	-4	-7.0	NM	39.0	NM	NM	NM	NM	3	0.6
PPG INDUSTRIES PPG	1907.0	-7	8169.0	-5	83.0	-34	387.0	-38	4.4	6.1	12.6	20	0.7
RPM RPM (7)	487.9	-2	1974.1	-2	24.5	45	78.3	33	5.0	3.4	11.6	21	0.7
TECUMSEH PRODUCTS TECUA	299.1	-17	1398.9	-15	6.1	-59	42.8	-35	2.0	4.1	4.4	20	2.3
USG USG	822.0	-2	3296.0	-13	-9.0	NM	16.0	NM	NM	NM	3.3	20	0.7
VALSPAR VAL (2)	525.4	33	1921.0	30	2.5	-90	51.5	-40	0.5	6.3	7.9	17	1.3
VULCAN MATERIALS VMC	728.1	5	3020.0	10	45.1	30	222.7	1	6.2	5.0	13.9	11	2.0

(B) CONSTRUCTION & REAL ESTATE

GROUP COMPOSITE	18174.3	22	62062.6	22	1568.5	34	4633.1	25	8.6	7.8	12.0	14	2.3
BEAZER HOMES USA BZH (3)	489.7	34	1929.8	22	23.2	62	84.4	67	4.7	3.9	22.5	8	8.7
BOSTON PROPERTIES BXP	267.4	17	1037.2	10	56.9	26	214.8	40	21.3	19.7	11.9	15	2.2
CENTEX CTX (9)	1894.5**	15	7492.1	16	96.1	40	371.0	51	5.1	4.1	19.6	9	6.0
CLAYTON HOMES CMH (6)	306.8	8	1178.2	-4	33.7	23	110.4	-15	11.0	9.6	9.2	19	0.7
CROSSMANN COMMUNITIES CROS	264.1	25	798.4	29	19.2	70	53.7	50	7.3	5.3	20.3	9	5.0
EQUITY OFFICE PROPERTIES TRUST EOP	920.9	37	3211.8	33	145.3	24	629.7	33	15.8	17.5	15.5	18	1.5
EQUITY RESIDENTIAL PROPERTIES TRUST EQR	538.3	2	2174.4	7	141.1	7	474.4	-15	26.2	24.9	15.3	19	1.1
FELCOR LODGING TRUST FCH	303.2	101	1208.3	118	-29.3	NM	-38.0	NM	NM	27.4	14.4	NM	-1.1
FOREST CITY ENTERPRISES FCE.A (11)	232.7**	10	880.7	15	66.6	102	94.4	-16	28.6	6.2	14.8	19	2.0
GENERAL GROWTH PROPERTIES GGP	328.9	3	1156.2	4	61.6	22	109.7	-21	18.7	15.8	7.2	26	1.6
HORTON (D.R.) DHI (3)	1159.9	31	4727.8	27	73.4	54	280.5	42	6.3	5.4	21.2	10	8.8
HOVNIAN ENTERPRISES HOV (2)	537.2**	52	1742.0	53	21.7	19	63.7	92	4.0	5.2	17.0	9	2.2
JONES LANG LASALLE JLL	267.5	-6	873.1	-4	-2.9	NM	-15.4	NM	NM	NM	-4.9	NM	-0.5
KB HOME KBH (1)	1450.9	17	4574.2	16	88.5	21	214.2	2	6.1	5.9	19.8	7	5.5
LENNAR LEN (1)	1937.9**	13	6002.3	20	162.9	49	417.8	82	8.4	6.4	25.2	9	6.0
M.D.C. HOLDINGS MDC	676.4	26	2124.9	21	47.1	20	155.7	26	7.0	7.3	23.8	7	5.7
MERISTAR HOSPITALITY MBH	227.5	-21	1084.9	-9	-60.3	NM	-40.0	NM	NM	4.9	-3.7	NM	-0.9
MERITAGE MTH	244.9**	45	742.6	44	15.9	33	50.9	42	6.5	7.1	28.8	6	8.6
MI SCHOTTENSTEIN HOMES MHO	309.4**	10	976.8	4	14.8	19	52.6	18	4.8	4.4	19.7	8	6.7
NVR NVR	733.4**	16	2623.8	13	67.0	44	236.8	50	9.1	7.4	67.8	10	24.8
OAKWOOD HOMES OH (3)	262.0**	-10	1066.4	-15	-10.0	NM	-133.4	NM	NM	NM	-57.0	NM	-14.1
PLUM CREEK TIMBER PCL	240.0	64	598.0	21	226.0	304	338.0	109	94.2	38.4	71.3	12	2.6
PULTE HOMES PHM	2002.1**	44	5381.9	27	119.5	40	302.4	39	6.0	6.1	13.3	8	6.7
RYLAND GROUP RYL	828.5	11	2741.8	18	44.8	42	136.5	60	5.4	4.2	24.1	8	9.5
SCHULER HOMES SHLR (9)	415.4	NA	1259.5	NA	27.1	NA	73.4	NA	6.5	NA	17.0	11	1.9
ST. JOE JOE	244.4	13	868.4	-1	18.8	-54	70.2	-30	7.7	19.0	13.7	14	0.7
STANDARD PACIFIC SPF	433.9	-14	1384.5	5	31.3	-24	111.1	11	7.2	8.2	19.4	7	3.8
TOLL BROTHERS TOL (2)	656.6**	7	2222.8	23	68.5	17	213.7	46	10.4	9.5	23.4	8	5.5

14 LEISURE TIME INDUSTRIES

INDUSTRY COMPOSITE	27263.0	-1	107293.1	1	697.9	-35	4497.1	-36	2.6	3.9	8.0	32	0.7
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(A) EATING PLACES

GROUP COMPOSITE	8692.3	6	34212.5	5	431.2	-23	2067.4	-17	5.0	6.8	14.4	24	1.1
ARAMARK RMK (3)	2109.7	8	7951.1	7	51.4	18	184.5	6	2.4	2.2	18.8	15	1.7
BOB EVANS FARMS BOBE (8)	271.1	5	1045.5	6	18.8	34	57.2	13	6.9	5.4	11.9	17	1.6
BRINKER INTERNATIONAL EAT (6)	704.7	21	2696.3	17	34.6	8	152.0	15	4.9	5.5	16.8	21	1.5
CBRL GROUP CBRL (5)	495.2	6	1991.6	10	19.6	16	51.9	-16	4.0	3.6	11.0	22	0.7
CKE RESTAURANTS CKR (11)	326.6	-20	1492.0	-22	-1.7	NM	-224.0	NM	NM	NM	-81.7	NM	-4.4
DARDEN RESTAURANTS DRI (7)	1013.5	5	4166.0	5	36.5	20	209.2	9	3.6	3.2	19.0	13	1.7
MCDONALD'S MCD	3771.5	5	14870.0	4	271.9	-40	1636.6	-17	7.2	12.6	16.8	22	1.2

(B) ENTERTAINMENT

GROUP COMPOSITE	4750.2	5	19330.6	11	147.3	NM	426.3	-13	3.1	NM	3.5	50	0.4
AMC ENTERTAINMENT AEN (9)	316.3	6	1292.5	9	-9.0	NM	-65.4	NM	NM	NM	-51.2	NM	-3.6
ARGOSY GAMING AGY	228.2	47	779.6	20	20.7	69	66.1	112	9.1	7.9	43.8	16	2.2
HARRAH'S ENTERTAINMENT HET	960.6	17	3709.0	11	55.1	NM	209.0	NM	5.7	NM	15.9	20	1.8
ISLE OF CAPRI CASINOS ISLE (6)	260.5	11	1036.8	24	10.4	8	21.2	-46	4.0	4.1	12.5	22	0.7
MANDALAY RESORT GROUP MBG (11) †	609.4**	-3	2521.4	4	23.3	-21	104.6	-6	3.8	4.7	8.9	19	1.3
METRO-GOLDWYN-MAYER MGM	375.5	29	1387.5	12	39.1	216	-55.7	NM	10.4	4.2	-2.3	NM	-0.2
MGM MIRAGE MGO	889.7	-13	3972.8	29	23.7	-65	170.6	3	2.7	6.7	5.3	29	1.0
PARK PLACE ENTERTAINMENT PPE	1110.0	3	4631.0	-1	-16.0	NM	-24.0	NM	NM	NM	-0.6	NM	-0.0

(C) HOTEL & MOTEL

GROUP COMPOSITE	1988.8	-23	9112.2	-11	-107.1	NM	190.3	-45	NM	1.0	0.9	NM	0.0
HILTON HOTELS HLT	662.0	-24	3050.0	-12	4.0	-94	166.0	-39	0.6	7.3	10.1	26	0.4
STARWOOD HOTELS & RESORTS HOT	878.0	-21	3967.0	-9	-54.0	NM	151.0	-62	NM	11.9	3.9	46	0.7
WYNDHAM INTERNATIONAL WYN	448.8	-26	2095.2	-15	-57.1	NM	-126.7	NM	NM	NM	-15.1	NM	-1.5

(D) OTHER LEISURE

GROUP COMPOSITE	11831.7	-3	44637.7	-3	226.6	-58	1813.0	-51	1.9	4.5	8.5	32	0.7
AMERICAN GREETINGS AM (10)	705.4	-8	2362.6	-4	6.6	-79	-236.9	NM	0.9	4.2	-25.9	NM	-3.7



WHAT KIND OF DECISIONS ARE REQUIRED IN TODAY'S BUSINESS CLIMATE? SMART ONES.

Arriving at a smart business decision can happen anywhere. But the process first requires information; information that needs to be gathered from multiple sources, then analyzed and shared before it can be used to your advantage.

The challenge today is twofold. One: how do you get the infrastructure in place to access disparate data sources and create and distribute actionable information? And, two: also meet the demands to reduce costs and increase productivity?

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 12/31	PRICE- EARNINGS RATIO	MOV. EARN. P/S
	QTH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	QTH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	QTH QUARTER 2001 %	QTH QUARTER 2000 %			
BRUNSWICK BC	717.8	-18	3370.8	-12	-2.6	NM	84.7	-58	NM	4.5	7.5	25	0
CARNIVAL CCL (1)	959.1	13	4535.8	30	116.3	-40	926.2	-4	12.1	22.8	14.1	10	1
CSS INDUSTRIES CSS (9)	235.9	13	426.1	1	23.1	8	21.3	17	9.8	10.1	19.5	12	2
EASTMAN KODAK EK	3359.0	-6	13234.0	-5	-206.0	NM	76.0	-95	NM	5.4	2.3	NM	0
FLEETWOOD ENTERPRISES FLE (8)	590.8	-21	2217.1	-32	-12.3	NM	-272.9	NM	NM	NM	-97.4	NM	-8
HARLEY-DAVIDSON HDI	911.4**	15	3424.7	16	118.4	26	437.7	26	13.0	12.2	24.9	38	1
HASBRO HAS	988.7	-15	2856.3	-25	52.5	NM	50.8	NM	5.3	NM	4.5	41	0
MATTEL MAT	1605.1	2	4804.1	3	138.0	31	310.9	83	8.6	6.7	17.9	24	0
POLARIS INDUSTRIES PI	424.4	5	1512.0	5	31.7	15	91.4	10	7.5	6.9	38.3	15	3
ROYAL CARIBBEAN CRUISES RCL	656.0	2	3145.3	10	-39.0	NM	254.5	-43	NM	4.7	6.5	13	1
TRANS WORLD ENTERTAINMENT TWM (11)	273.4	3	1430.4	4	-11.6	NM	22.4	-63	NM	NM	5.3	16	0
UNITED DEFENSE INDUSTRIES UDI	404.7	25	1318.5	11	11.6	214	37.0	103	2.9	1.2	NM	29	0
15 MANUFACTURING													
INDUSTRY COMPOSITE	43972.7	-5	177469.3	-1	641.8	-72	5553.2	-42	1.5	4.9	10.9	33	1.3
(A) GENERAL MANUFACTURING													
GROUP COMPOSITE	18693.6	1	73341.5	2	657.5	0	3284.4	-23	3.5	3.5	15.1	28	1.9
AVERY DENNISON AVY	912.6	-2	3803.3	-2	58.1	-14	243.4	-14	6.4	7.2	26.2	24	2
BLUTH BTH (11)	319.2	-2	1162.7	-4	25.9	-14	65.6	-32	8.1	9.2	14.3	15	1
BUTLER MFG. BBR	238.4	-4	896.6	-7	1.5	-78	8.1	-68	0.6	2.8	4.8	30	1
CARLISLE CSL	433.5	5	1849.5	4	7.6	-28	24.8	-74	1.7	2.6	3.8	30	0
COACH COH (6)	235.8	12	653.8	13	44.2	13	73.9	34	18.7	18.6	34.9	26	1
ENERGIZER HOLDINGS ENR (3)	567.7	2	1702.6	-6	70.4	30	-22.8	NM	12.4	9.7	-3.8	NM	-0.3
FEDERAL SIGNAL FSS	273.9	-9	1072.2	-3	9.4	-28	46.6	-19	3.4	4.3	13.0	22	1
FORTUNE BRANDS FB	1376.8	-2	5318.3	-2	128.8	NM	386.0	NM	9.4	NM	17.8	17	2
GRIFFON GFF (3)	301.9	5	1173.8	4	10.6	41	33.7	49	3.5	2.6	11.5	17	1
HANSCO HSC	517.8	-4	2107.1	5	10.0	-61	71.7	-26	1.9	4.8	10.6	19	1
HEXCEL HXL	239.1	-7	1009.4	-4	-414.2	NM	-431.0	NM	NM	0.4	NM	NM	-11.5
INTERNATIONAL GAME TECHNOLOGY IGT (3)†	301.5	11	1230.3	5	51.8	7	217.5	34	17.2	17.8	51.2	24	2
JOHNSON CONTROLS JCI (3)	4817.7	5	18790.5	5	119.9	17	495.7	4	2.5	2.3	16.7	15	5
MINNESOTA MINING & MFG. MMM	3863.0	-7	16079.0	-4	381.0	-5	1430.0	-23	9.9	9.7	23.5	31	3
NCI BUILDING SYSTEMS NCS (2)	271.0	-3	954.9	-6	5.3	-66	16.5	-63	2.0	5.7	5.0	13	0
NEWELL RUBBERMAID NWE	1806.1	2	6909.3	0	70.7	-25	264.6	-37	3.9	5.4	10.9	27	0
PARKER HANNIFIN PH (6)	1437.3	-2	5940.1	2	29.1	-63	230.5	-46	2.0	5.3	8.9	23	1
SHAW GROUP SGR (4)	453.6	5	1573.8	5	19.0	56	68.0	25	4.2	2.9	11.2	11	1
TUPPERWARE TUP	326.7	10	1114.4	4	28.5	30	61.5	-18	8.7	7.4	55.0	18	1
(B) MACHINE & HAND TOOLS													
GROUP COMPOSITE	3026.2	-5	11766.2	-5	-5.8	NM	411.8	-44	NM	4.2	11.3	27	1.3
BLACK & DECKER BDK	1220.7	-3	4333.1	-5	-13.0	NM	108.0	-62	NM	4.2	14.4	30	1
KENAMETAL KMT (6)	380.3	-14	1697.7	-9	-2.5	NM	40.4	-29	NM	3.0	5.1	27	1
LINCOLN ELECTRIC HOLDINGS LECO	237.0	-6	978.9	-8	20.6	138	83.6	7	8.7	3.4	16.6	13	1
SNAP-ON SNA	542.6**	-4	2131.4	-4	-17.4	NM	21.5	-83	NM	2.4	2.8	33	0
STANLEY WORKS SWK	645.6	-3	2625.1	-5	6.5	-86	158.3	-19	1.0	7.0	19.0	24	1
(C) SPECIAL MACHINERY													
GROUP COMPOSITE	20925.2	-10	87150.5	-3	-66.5	NM	2695.8	-57	NM	6.2	7.8	41	1.0
AGCO AG	772.9	21	2541.5	9	23.2	201	23.4	569	3.0	1.2	2.9	39	0
APPLIED MATERIALS AMAT (2)	1264.7	-57	7343.2	-23	-82.3	NM	775.2	-62	NM	22.7	10.2	45	0
BRIGGS & STRATTON BGG (6)	335.3	-9	1319.6	-7	2.4	-88	19.3	-77	0.7	5.4	4.9	35	0
CATERPILLAR CAT	5096.0	5	20450.0	1	167.0	-37	805.0	-24	3.3	5.2	14.3	20	2
CRANE CR	372.7	5	1587.2	5	18.0	-33	33.5	-28	4.8	7.5	13.6	15	1
CUMMINS CUM	1463.0	-9	5681.0	-14	3.0	NM	-102.0	NM	0.2	NM	-10.0	NM	-2.6
DEERE DE (2)	3161.1**	-6	13292.9	1	-320.1	NM	-64.0	NM	NM	2.1	-1.6	NM	-0.2
DONALDSON DCI (5)	288.4	5	1135.6	0	19.7	17	78.5	12	5.8	5.8	23.8	20	1
DOVER DOV	1049.5	-20	4459.7	-14	37.0	-71	166.8	-68	3.5	9.7	10.4	45	0
FLOWERVE FLS	539.3	5	1917.5	25	16.5	571	16.4	7	3.1	0.3	3.0	58	0
FMC FMC	489.8	5	1943.0	-5	-35.7	NM	-306.3	NM	NM	6.3	-54.9	NM	-9.8
ILLINOIS TOOL WORKS ITW	2278.3	-5	9292.8	-2	187.7	-10	802.4	-17	8.2	8.7	13.3	36	2
ITT INDUSTRIES ITT	1181.8	-3	4675.7	-3	14.0	-82	216.7	-18	1.2	6.4	16.7	23	2
JOY GLOBAL JOYG (2)	302.8	5	1148.2	2	-72.7	NM	-25.9	NM	NM	4.2	-5.3	NM	N
LAM RESEARCH LRCX (6)	259.2	-33	1429.4	3	-51.7	NM	29.8	-85	NM	8.1	1.5	NM	0
MANITOWOC MTW	288.0	5	1116.6	5	5.5	-17	48.9	-19	3.0	5.0	18.5	17	1
PENTAIR PNR	595.9	-12	2615.9	-5	-16.3	NM	57.5	-30	NM	NM	5.7	28	1
STEWART & STEVENSON SERVICES SSSS (11)	329.7	15	1400.4	27	11.7	36	56.6	96	3.5	3.0	14.1	9	1
TIMKEN TKR	573.6	-9	2447.2	-7	1.2	32	-41.7	NM	0.2	0.1	-5.3	NM	0.6
TORO TTC (2)	283.4**	5	1353.1	1	2.2	113	50.4	11	0.5	0.4	14.5	13	3
(D) TEXTILES													
GROUP COMPOSITE	1327.6	5	5211.1	0	56.6	57	161.2	62	4.3	2.4	96.4	19	1.5
MOHAWK INDUSTRIES MHH	895.8	7	3445.9	1	59.2	51	128.6	16	6.6	4.7	21.3	15	3
WESTPOINT STEVENS WKS	431.8	3	1765.1	-3	-2.6	NM	-27.3	NM	NM	NM	NM	NM	-0.5



WHAT KIND OF DECISIONS DOES MICROSOFT® MAKE? SMART ONES.

Living at a smart business decision can happen anywhere. At the process first requires information; information that needs to be gathered from multiple sources, then analyzed and shared before it can be used to your advantage. Microsoft knows this. That's why they

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 12-31	PRICE- EARNING RATIO 2/1	MARKET CAP \$ BIL.
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	12 MONTHS 2001 %			
16 METALS & MINING													
INDUSTRY COMPOSITE	16139.6	-17	71629.2	-7	-1205.3	NM	-1720.3	NM	NM	1.2	-7.6	NM	-0.
(A) STEEL													
GROUP COMPOSITE	7205.6	-8	31284.7	-10	-1101.9	NM	-2794.4	NM	NM	NM	-40.3	NM	-4.
AK STEEL HOLDING AKS	973.0	-8	3994.1	-13	-76.4	NM	-92.4	NM	NM	1.5	-9.1	NM	-0.
ALLEGHENY TECHNOLOGIES ATI	493.1	-16	2128.0	-14	-45.8	NM	-25.2	NM	NM	0.9	-2.7	NM	-0.
BETHLEHEM STEEL BS	719.9	-18	3334.3	-19	-547.1	NM	-1949.6	NM	NM	NM	NM	NM	-15.
CARPENTER TECHNOLOGY CRS (6)	248.1	-15	1238.1	3	3.5	-74	15.9	-73	1.4	4.6	2.3	NM	0.
COMMERCIAL METALS CMC (4)	564.9	-5	2411.6	-9	8.8	NM	35.4	5	1.6	NM	NM	13	2.
NATIONAL STEEL NBS	592.7	-9	2492.3	-16	-280.3	NM	-667.3	NM	NM	NM	NM	NM	16.
NUCOR NUC	979.6	-3	4139.2	-10	26.5	-67	113.0	-64	2.7	7.9	5.2	37	1.
RYERSON TULL RT	479.8	-23	2243.5	-22	-45.0	NM	-60.2	NM	NM	NM	-9.4	NM	-2.
TEXAS INDUSTRIES TXI (7)	346.2	13	1313.2	-4	16.6	67	12.2	-84	4.8	3.2	1.7	NM	0.
UNITED STATES STEEL X	1398.0	-1	6286.0	3	-174.0	NM	-218.0	NM	NM	NM	-12.3	NM	52.
WORTHINGTON INDUSTRIES WOR (7)	410.4	-10	1704.4	-13	11.3	65	41.8	-35	2.8	1.5	6.5	NM	0.
(B) OTHER METALS													
GROUP COMPOSITE	8934.0	-23	40344.4	-4	-103.4	NM	1074.1	-43	NM	3.9	6.2	44	0.
ALCOA AA	5181.0	-21	22859.0	0	-142.0	NM	908.0	-39	NM	6.0	8.6	32	1.
ENGELHARD EC	871.0**	-44	5096.9	-8	60.5	NM	225.6	34	6.9	NM	22.5	10	1.
FREEMONT-MCMORAN COPPER & GOLD FCX	412.3	-22	1838.9	-2	7.1	-89	113.0	47	1.7	12.7	NM	19	0.
GENERAL CABLE GGC	360.3	-15	1651.4	-7	3.4	-73	37.5	-31	0.9	2.9	35.7	11	1.
MUELLER INDUSTRIES MLI	228.8**	-20	1044.8	-16	11.7	-31	67.0	-28	5.1	5.9	10.0	17	1.
NEWMONT MINING NEM	445.2	-15	1656.1	-8	22.1	NM	-23.3	NM	5.0	NM	-2.1	NM	10.
OLIN OLN	278.3	-22	1270.6	-18	0.9	-94	-9.5	NM	0.3	4.2	-3.5	NM	10.
PHELPS DODGE PD	901.2	-18	4002.4	-12	-78.3	NM	-273.0	NM	NM	0.7	-10.1	NM	13.
QUANEX NX (2)	256.0	5	924.4	-4	11.2	NM	28.8	NM	4.4	NM	10.3	14	2.
17 NONBANK FINANCIAL													
INDUSTRY COMPOSITE	141220.8	-8	590910.0	0	10838.5	-21	49200.7	-20	7.7	8.9	12.4	21	2.1
(A) FINANCIAL SERVICES													
GROUP COMPOSITE	76154.0	-15	342882.8	-4	6275.1	-23	30433.7	-22	8.2	9.0	15.3	20	2.1
AMERICAN EXPRESS AXP	5871.0**	-3	22582.0	-5	297.0	-56	1311.0	-53	5.1	11.2	10.7	34	0.9
AMERICREDIT ACF (6)	286.7	52	1024.8	61	80.6	66	291.5	22	28.1	25.7	27.0	6	3.3
BEAR STEARNS BSC (1)	1813.7	-32	8701.0	-15	154.9	-21	625.0	-19	8.5	7.3	13.5	13	4.2
BLOCK (H&R) HRB (8)	378.7	12	3062.8	11	-28.0	NM	319.4	37	NM	NM	35.0	27	1.
CAPITAL ONE FINANCIAL COF	1981.9	26	7254.3	34	177.7	39	642.0	37	9.0	8.1	19.3	16	2.9
CITIGROUP C	26650.0	-9	112022.0	0	3875.0	36	14284.0	6	14.5	9.7	16.5	10	2.7
DUN & BRADSTREET DNB	340.0	-10	1308.8	-8	56.5	207	153.2	108	16.6	4.9	NM	19	1.8
E*TRADE GROUP ET	519.0	-10	2084.3	-5	7.7	433	-270.8	NM	1.5	0.2	-17.2	NM	-0.8
EDWARDS (A.G.) AGE (10)	559.7	-15	2438.6	-19	22.2	-61	154.4	-55	4.0	8.6	9.3	12	1.9
EQUIFAX EFX	281.9	-1	1139.0	-4	9.1	-78	117.3	-17	3.2	14.8	44.5	10	0.8
FRANKLIN RESOURCES BEN (3)	618.2**	10	2409.0	8	118.5	-21	453.8	-21	19.2	26.5	11.1	21	1.7
GALLAGHER (ARTHUR J.) AJG	254.0	15	910.0	14	33.1	84	125.3	35	13.0	11.1	36.5	25	1.3
GOLDMAN SACHS GROUP GS (1)	6118.0	-23	31138.0	-6	497.0	-17	2310.0	-25	8.1	7.5	12.9	10	4.2
HOUSEHOLD INTERNATIONAL HI	3643.6	11	13915.7	16	548.9	11	1923.5	13	15.1	15.1	23.8	12	4.0
LEGG MASON LM (9)	403.8	3	1537.8	-2	41.1	-1	144.2	-15	10.2	10.5	13.8	14	2.
LEHMAN BROTHERS HOLDINGS LEH (1)	4300.0	-33	22392.0	-15	130.0	-67	1255.0	-29	3.0	6.2	15.7	13	4.3
MARSH & MCLENNAN MMC	2473.0	0	9943.0	-2	144.0	-50	974.0	-18	5.8	11.6	19.1	30	3.3
MERRILL LYNCH MER	7610.0	-35	38793.0	-14	-1264.0	NM	573.0	-85	NM	7.5	2.6	10	0.5
METRIS MXT	541.5	46	1851.4	29	70.7	NM	260.3	31	13.1	13.1	30.2	8	1.6
MORGAN STANLEY DEAN WITTER MWD (1)	8218.0	-20	43727.0	-3	870.0	18	3610.0	-34	10.6	7.1	15.2	15	3.1
PRICE (T. ROWE) GROUP TROW	241.3**	-17	1027.5	-15	45.0	-19	195.9	-27	18.7	19.0	18.2	15	1.5
RAYMOND JAMES FINANCIAL RJF (3)	364.1	-14	1601.0	-8	18.1	-44	82.3	-37	5.0	7.6	10.7	10	1.6
SCHWAB (CHARLES) SCH	1197.0**	-29	5281.0	-26	-13.0	NM	78.0	-89	NM	8.2	1.9	NM	0.0
STILWELL FINANCIAL SV	334.1	-37	1555.7	-31	73.7	-52	302.3	-54	22.1	28.9	22.1	18	1.3
STUDENT LOAN STU	269.9	-16	1162.2	6	43.3	64	135.4	29	16.0	8.2	20.8	13	6.7
USA EDUCATION EDU	884.9	-22	4020.8	-3	265.9	170	334.0	-17	30.1	8.7	24.7	39	2.2
(B) INSURANCE													
GROUP COMPOSITE	56519.3	5	218782.6	4	3274.4	-30	13393.1	-30	5.8	8.6	8.1	28	1.8
AFLAC AFL	2404.0	-3	9598.0	-1	163.0	-2	687.0	0	6.8	6.7	12.4	19	1.2
ALLSTATE ALL	7358.0	2	28865.0	-1	264.0	-52	1167.0	-47	3.6	7.6	6.7	20	1.6
AMERICAN INTERNATIONAL GROUP AIG	14571.7**	7	55459.3	10	1865.9	4	5499.0	-17	12.8	13.2	10.8	34	3.0
AMERICAN NATIONAL INSURANCE ANAT	554.9	30	2134.4	16	-8.7	NM	64.9	-54	NM	NM	2.2	14	2.4
AMERUS GROUP AMH	402.9**	49	1287.5	19	19.1	0	79.3	55	4.7	6.7	6.4	18	2.1
CIGNA CI	4942.0	-8	19115.0	-4	191.0	-31	980.0	0	3.9	5.4	18.6	14	6.5
CINCINNATI FINANCIAL CINF	653.7	12	2560.8	10	36.0	NM	193.3	63	5.5	NM	3.2	12	1.1
COMMERCE GROUP CGI	296.5	0	1153.8	0	28.1	-49	93.1	-30	9.5	19.1	11.5	13	2.7
HARTFORD FINANCIAL SERVICES GROUP HFG	3856.0	-1	15147.0	3	152.0	-44	549.0	-44	3.9	7.0	6.3	10	2.1
JEFFERSON-PILLOT JP	802.2	-1	3332.3	3	96.4	-15	512.8	0	12.0	14.1	14.9	18	3.

•SHE
SOUNDED
SHORTER ON
THE PHONE.☎

OOH, I STILL
HAVE A
BAR
STAMP
ON MY
WRIST.☺☺

4 COMPANIES
3 OFFERS (AND COUNTING)
I'M IN THE CATBIPO-SEAT NOW

WHO CARES
HOW MUCH
FLEXIBILITY
I HAVE WITH
MY 401(K). I
JUST WANT
TO RETIRE
IN 2 YEARS.

THIS
PLACE LOOKS
NOTHING LIKE
THE BROCHURE
DESCRIBED.☹

HOW MANY QUARTERS
DID I PUT IN THE METER?

PLEASE SAY
3 WEEKS OF
VACATION.→

PLEASE SAY
3 WEEKS OF
VACATION.→

PLEASE
SAY...☹

FIRST
THINGS
FIRST. THE
ELEVATOR
MUSIC HAS
NOT→→→

OH MAN,
DO I
NEED

...I WONDER HOW BIG MY
BE. WILL MY WINDOW
I LOVE BLINDS.

...I WONDER HOW BIG MY
BE. WILL MY WINDOW
I LOVE BLINDS.

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I LOVE BLINDS.

...I WONDER HOW BIG MY
BE. WILL MY WINDOW
I LOVE BLINDS.

..WHAT
CAN I
DO TO
GET→
THIS GUY
TO JOIN?☹

NOW, THAT'S
A PECULIAR
LOOKING
TATTOO.☹☹

☺ I HOPE I DON'T HAVE
SOMETHING IN MY TEETH.
I REMEMBER THE
GOOD OLD DAYS
WHEN "STOCK
OPTIONS" MEANT
SOMETHING.☹☹☹

MY NEW SHAMPOO
HAS STOPPED THE
ITCHING, STOPPED
THE FLAKES.☹☹

LOVELY
WEATHER.
☺☺☺

☺☺☺
EVERYONE BE
AS FIRED UP AS OUR
RECEPTIONIST, JEN?

I DON'T
UNDERSTAND
WHY MORE PEOPLE DON'T
USE PIE CHARTS. THEY'RE SO EASY.

I SHOULD
HAVE BEEN
A TOLL
BOOTH
ATTENDANT.

COULD THIS GUY
HANDLE THE
POLITICS→

HERE?☹

HERE?
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..ONLY:
47 HOURS
53 MINUTES
TIL I'M OUT
OF HERE.
IN HINDSIGHT,
I'M NOT SURE PRE-
LAW WAS THE
RIGHT MAJOR
FOR
ME. I DON'T
BE FOOLED
BY THE PHONE
ANSWERING THING.
I'M RUNNING THIS
PLACE. I
SHOULD
HAVE BEEN A CRUISE DIRECTOR.

People issues are complex. Managing them doesn't have to be.

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS				RETURN ON COMMON EQUITY 12 MONTHS ENDING 12-31	PRICE- EARNING RATIO 2-7	MOM. EARN. P. SH.
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %	12 MONTHS 2001 %	12 MONTHS 2000 %			
JOHN HANCOCK FINANCIAL SERVICES JHF	2672.8**	9	9361.3	6	102.3	-55	611.5	-25	3.8	9.2	10.5	10.5	18	1	
LINCOLN NATIONAL LNC	1504.4	-15	6411.4	-6	169.2	14	590.2	-5	11.2	8.4	11.3	11.3	16	3	
MARKEL MKL	386.3	16	1397.4	28	-43.7	NM	-125.7	NM	NM	NM	-13.8	NM	NM	-14	
MBIA MBI	296.6	8	1137.8	8	156.4	15	583.2	10	52.7	49.7	12.2	12.2	14	3	
MGIC INVESTMENT MVB	358.0**	22	1357.8	22	161.0	22	639.1	18	45.0	45.3	21.2	21.2	11	5	
MONEY GROUP MNY	524.9	11	2103.6	-4	-87.7	NM	-60.8	NM	NM	1.9	-3.0	NM	NM	-1	
NATIONWIDE FINANCIAL SERVICES NFS	805.5**	0	3206.8	0	58.6	-46	419.9	-3	7.3	13.6	12.2	12.2	12	3	
OHIO CASUALTY OCAS	485.1	10	1902.0	10	41.8	NM	98.6	NM	8.6	NM	9.1	9.1	11	1	
OLD REPUBLIC INTERNATIONAL ORI	637.0	14	2373.4	15	89.0	-4	347.0	17	14.0	16.6	12.9	12.9	10	2	
PHOENIX PNK	626.1	-9	2421.8	-19	-7.5	NM	-137.3	NM	NM	NM	-5.7	NM	NM	-1	
PMA CAPITAL PMACA	229.1	29	850.0	29	6.6	-46	7.1	436	2.9	6.9	1.2	6.0	60	0	
PMI GROUP PMI	279.0**	39	937.0	23	86.0	0	312.0	20	30.8	33.0	17.5	17.5	10	6	
PROGRESSIVE PGR	1988.3	13	7475.5	11	124.7	160	411.4	792	6.3	2.7	12.7	12.7	27	3	
RADIAN GROUP RON	263.1	0	948.2	54	96.1	0	360.4	45	36.5	40.3	15.5	15.5	11	3	
REINSURANCE GROUP OF AMERICA RGA	551.0	10	1968.3	14	-21.2	NM	39.9	-62	NM	5.8	4.3	5.5	55	0	
SAFECO SAFC	1665.3**	0	6866.9	-2	8.6	39	-1045.2	NM	0.5	0.4	-28.8	NM	NM	-8	
SELECTIVE INSURANCE GROUP SIGI	277.3	6	1063.5	8	6.8	-3	26.3	-1	2.5	2.7	4.4	4.4	24	0	
ST. PAUL SPC	2388.0	19	8943.0	12	-718.3	NM	-1008.8	NM	NM	9.3	-17.1	NM	NM	-4	
STANCORP FINANCIAL GROUP SFG	408.2	3	1585.4	8	27.9	59	106.0	12	6.8	4.4	10.7	10.7	15	3	
TORCHMARK TMR	678.4	5	2709.5	7	83.1	-10	356.5	-2	12.3	14.3	15.3	15.3	13	2	
TRANSATLANTIC HOLDINGS TRH	495.2	5	2030.2	7	6.5	-87	18.9	-91	1.3	10.8	1.0	NM	NM	0	
UCI UCI	302.2	20	1109.6	8	9.4	NM	48.4	51	3.1	NM	11.5	11.5	14	1	
UNITRIN UTR	513.4	10	2533.8	30	-12.1	NM	380.9	319	NM	6.0	19.9	19.9	7	5	
UNUMPROVIDENT UNM	2342.3	2	9435.4	0	124.0	-17	579.2	3	5.3	6.5	11.6	11.6	11	2	
(C) SAVINGS & LOAN															
GROUP COMPOSITE	8547.6	-6	37252.6	10	1289.0	38	5373.8	44	15.1	10.3	17.5	17.5	11	2	
ASTORIA FINANCIAL ASFC	370.0**	-8	1539.5	-4	54.8	5	225.2	4	14.8	12.8	14.2	14.2	12	2	
CHARTER ONE FINANCIAL CF	732.9**	4	2851.9	8	135.1	24	500.7	15	18.4	15.6	17.1	17.1	13	2	
COMMERCIAL FEDERAL CFB	239.4	29	991.8	1	25.1	NM	97.7	NM	10.5	NM	13.3	13.3	12	1	
GOLDEN STATE BANCORP GSB	990.0**	-16	4319.6	-5	109.2	22	410.9	18	11.0	7.6	16.0	16.0	10	2	
GOLDEN WEST FINANCIAL GOW	1019.8**	-11	4446.4	12	228.0	53	818.8	50	22.4	13.1	19.1	19.1	12	5	
GREENPOINT FINANCIAL GPT	448.2	30	1721.5	31	115.5	69	409.5	60	25.8	19.9	23.1	23.1	11	4	
SOVEREIGN BANCORP SOV	613.3**	-10	2648.5	11	73.5	NM	123.3	NM	12.0	NM	5.6	5.6	27	0	
WASHINGTON MUTUAL WM	3859.0	-8	17692.0	12	535.0	5	2732.0	44	13.9	11.9	19.4	19.4	10	3	
WESTCORP WES	274.9**	21	1041.5	37	12.9	-32	55.7	-25	4.7	8.3	10.3	10.3	11	1	
18 OFFICE EQUIPMENT & COMPUTERS															
INDUSTRY COMPOSITE	125463.9	-4	493669.0	3	3672.0	-54	-3889.7	NM	2.9	6.1	-1.0	NM	NM	-0.1	
(A) BUSINESS MACHINES & SERVICES															
GROUP COMPOSITE	10349.6	-17	43153.5	-8	295.4	-33	1296.6	-23	2.9	3.6	14.6	14.6	23	1	
COMPUCON SYSTEMS CMPC	367.7	-48	1815.5	-33	1.7	-78	6.7	30	0.5	1.1	2.6	2.6	20	0	
DELUXE DLX	318.7	5	1278.4	1	48.0	27	185.9	10	15.1	12.5	23.5	23.5	17	2	
DIEBOLD DBD	508.2	7	1760.3	1	17.3	-51	66.9	-51	3.4	7.3	7.6	7.6	10	0	
HON INDUSTRIES HNI	426.9	-18	1792.4	-12	23.3	-3	74.4	-30	5.4	4.6	12.6	12.6	10	1	
MILLER (HERMAN) MLHR (7)	395.0	-36	1877.3	-15	-22.7	NM	40.2	-73	NM	6.9	13.2	13.2	13	0	
NCR NCH	1600.0	-11	5917.0	-1	71.0	-21	221.0	24	4.4	5.0	10.9	10.9	18	2	
PITNEY BOWES FBI	1090.8	11	4122.5	6	100.4	-27	514.3	-9	9.2	14.1	57.8	57.8	10	2	
STANDARD REGISTER SR	285.7	-19	1196.4	-12	11.3	NM	-49.3	NM	3.9	NM	-11.9	NM	NM	-1.7	
STEELCASE SCS (10)	731.4	-29	3371.5	-15	4.9	-91	61.0	-71	0.7	5.0	3.8	3.8	10	0	
TECH DATA TECD (11)	4215.9	-19	18349.5	-8	28.5	-40	127.0	-22	0.7	0.9	10.0	10.0	22	2	
WALLACE COMPUTER SERVICES WCS (5)	409.2	-5	1672.7	0	11.8	-28	48.5	136	2.9	3.8	8.3	8.3	10	1	
(B) COMPUTERS & PERIPHERALS															
GROUP COMPOSITE	66887.1	-17	267854.8	-9	2241.2	-49	5514.9	-71	3.4	5.4	6.2	7.8	7	0	
APPLE COMPUTER AAPL (3)	1375.0	37	5731.0	-14	38.0	NM	208.0	-47	2.8	NM	5.2	4.1	41	0	
COMPAQ COMPUTER CPQ	8456.0	-26	33554.0	-21	92.0	NM	-563.0	NM	1.1	NM	-5.5	NM	NM	-0.3	
DELL COMPUTER DELL (11)	7468.0	-10	31781.0	8	429.0	-36	1224.0	-45	5.7	8.2	25.6	25.6	58	0	
EMC EMC	1512.7	-42	7090.6	-20	-70.2	NM	-507.7	NM	NM	21.5	-6.7	NM	NM	-0.2	
GATEWAY GTW	1135.4	-54	6079.5	-37	5.1	NM	-1014.4	NM	0.4	NM	-64.8	NM	NM	13	
HEWLETT-PACKARD HWP (2)	10876.0	-18	45226.0	-7	84.0	-91	624.0	-82	0.8	6.9	3.9	6.5	65	0	
INTERNATIONAL BUSINESS MACHINES IBM	22826.0	-11	85866.0	-3	2333.0	-13	7723.0	-5	10.2	10.4	32.7	32.7	24	4	
LEXMARK INTERNATIONAL LXX	1152.0	8	4142.8	0	36.8	-33	273.6	-4	3.2	5.0	25.4	25.4	26	2	
MAXTOR MXD	1079.6	18	3797.0	40	-162.2	NM	-646.4	NM	NM	0.7	-71.8	NM	NM	13	
PALM PALM (7)	290.6	-44	1141.0	-26	-25.2	NM	-451.6	NM	NM	3.9	-65.3	NM	NM	-0.7	
QUANTUM DLT & STORAGE SYSTEMS QSS (8)	284.0	-23	1153.8	-21	-0.6	NM	-28.8	NM	NM	12.9	-4.9	NM	NM	10	
SILICON GRAPHICS SGI (6)	363.9	-25	1684.5	-16	37.2	NM	-405.0	NM	10.2	NM	NM	NM	NM	-2.1	
STORAGE TECHNOLOGY STK	566.4	-6	2045.3	-1	40.0	30	67.2	NM	7.1	5.1	6.5	6.5	37	0	
SUN MICROSYSTEMS SUNW (8)	3108.0	-39	14059.0	-27	-431.0	NM	-563.0	NM	NM	8.3	-5.7	NM	NM	-0.1	
UNISYS UIS	1556.9	-19	6018.1	-13	-169.4	NM	-49.9	NM	NM	2.0	-2.4	NM	NM	-0.1	
WESTERN DIGITAL WDC (6)	574.7	2	1983.1	0	12.7	347	-44.0	NM	2.2	0.5	-90.1	NM	NM	-0.2	
XEROX XRX	4262.0	-13	16502.0	-12	-8.0	NM	-331.0	NM	NM	NM	-10.9	NM	NM	-0.4	

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGIN		RETURN ON COMMON EQUITY 12 MONTHS ENDING 12-31	PRICE/EARNINGS RATIO 2-7	MOV EARLY F-S
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
(C) COMPUTER SOFTWARE & SERVICES													
GROUP COMPOSITE	48227.2	30	182660.7	31	1135.4	-65	-10701.2	NM	2.4	8.6	-3.7	NM	-0.1
ACTIVISION ATVI ⁽⁹⁾	371.3	40	748.3	25	89.1	91	42.2	NM	10.5	7.8	11.0	83	0
ADOBE SYSTEMS ADBE ⁽¹⁾	264.5	-26	1229.7	-3	34.3	-57	205.6	-29	13.0	22.3	33.3	81	0
AFFILIATED COMPUTER SERVICES ACS ⁽⁶⁾	750.4	50	2489.5	23	55.6	74	171.2	42	7.4	6.4	10.0	81	2
AOL TIME WARNER AOL	10632.0	NA	38234.0	NA	-1822.0	NA	-4921.0	NA	NM	NA	-3.2	NM	-1
AUTOMATIC DATA PROCESSING ADP ⁽⁸⁾	1681.0**	8	7036.3	5	264.6	22	1005.1	15	15.7	12.7	20.7	84	1
BMC SOFTWARE BMC ⁽⁹⁾	317.6	-18	1373.4	-12	-94.5	NM	-159.3	NM	NM	5.7	18.8	NM	-0
CADENCE DESIGN SYSTEMS CDSN	378.2	-3	1430.4	12	38.9	-8	141.3	123	10.3	10.9	12.6	81	0
CERIDIAN CEN	301.7	-1	1182.3	1	22.8	-34	49.5	-38	7.6	11.3	4.7	84	0
CISCO SYSTEMS CSCO ⁽⁵⁾	4448.0	-32	20222.0	-6	-268.0	NM	-2080.0	NM	NM	12.2	-7.6	NM	-0
COMPUTER ASSOCIATES INTL. CA ⁽⁹⁾	749.0	-4	2929.0	-45	-231.0	NM	-1274.0	NM	NM	NM	-26.0	NM	-2
COMPUTER SCIENCES CSC ⁽⁹⁾	2900.9	9	11276.9	11	87.1	33	165.6	-60	3.0	2.5	4.9	NM	0
COMPUWARE CPWR ⁽⁸⁾	450.6	-9	1835.8	-12	29.8	-17	137.3	15	5.6	7.3	9.2	83	0
DST SYSTEMS DST	416.6	19	1660.0	22	51.3	-24	228.2	5	12.3	19.4	17.6	28	1
EARTHLINK ELNK	327.2	14	1244.9	26	-73.9	NM	-341.1	NM	NM	NM	-40.2	NM	-2
EDWARDS (J.D.) JDEC ⁽²⁾	235.4	-15	874.0	-13	18.0	86	-179.8	NM	7.6	3.5	-60.1	NM	1
ELECTRONIC ARTS ERTS ⁽⁹⁾	832.9	30	1562.2	19	132.3	50	36.3	255	15.9	13.7	3.1	NM	0
ELECTRONIC DATA SYSTEMS EDS	5906.0	14	21543.0	12	405.0	26	1387.0	21	6.9	6.2	21.5	21	2
FIRST DATA FDC	1682.1**	12	6450.8	13	287.8	20	874.6	-6	17.1	15.9	25.6	37	2
FISERV FISV	496.7	14	1890.5	14	52.8	20	208.2	18	10.6	10.1	14.7	88	1
GTECH HOLDINGS GTK ⁽¹⁰⁾	263.6	19	981.0	2	21.6	18	83.3	76	8.2	11.3	40.1	19	2
IMATION IMN	313.9	2	1176.5	-5	-26.6	NM	-1.7	NM	NM	NM	-0.3	NM	-0
MICROSOFT MSFT ⁽⁸⁾	7741.0	18	26847.0	13	2283.0	-13	6082.0	-39	29.6	40.1	11.8	55	1
NETWORK ASSOCIATES NETA	259.2	341	834.5	12	-4.1	NM	-101.0	NM	NM	NM	-25.9	NM	-0
NOVELL NOVL ⁽²⁾	307.6	13	1040.1	-10	-94.5	NM	-261.8	NM	NM	NM	-20.6	NM	-0
ORACLE ORCL ⁽⁷⁾	2357.3	-11	10537.6	-2	549.5	-12	2497.7	-63	23.3	23.4	41.8	87	0
PEOPLESOFT PSFT	528.2	8	2073.3	19	57.8	31	191.6	31	10.9	11.9	12.0	86	0
PRICELINE.COM PCN	235.3	3	1171.8	-5	-1.3	NM	-7.3	NM	NM	NM	-10.8	NM	-0
REYNOLDS & REYNOLDS REY ⁽³⁾	240.1	-5	992.4	1	25.4	5	99.5	14	10.6	9.9	20.9	19	1
SABRE HOLDINGS TSG	422.8**	-9	2103.1	8	-69.7	NM	-47.0	NM	NM	NM	-4.3	NM	-0
SIEGEL SYSTEMS SEBL	481.4	-17	2048.4	14	65.9	-17	254.6	15	13.7	13.7	13.9	66	0
SOFTWARE SPECTRUM SSPE ⁽⁸⁾	355.9	25	1347.6	27	1.4	NM	5.1	104	0.4	NM	12.3	13	1
SYBASE SY	236.3	-9	926.1	-4	6.1	-83	-25.5	NM	2.6	13.6	-3.6	NM	-0
SYMANTEC SYMC ⁽⁹⁾	290.2	32	1011.3	28	0.1	-99	-60.4	NM	0.0	6.3	-4.8	NM	-0
3COM COMS ⁽⁷⁾	393.9	-50	1881.1	-48	-103.7	NM	-1099.8	NM	NM	NM	-50.4	NM	-3
VERISIGN VRSM	283.8	44	983.6	107	-401.1	NM	-1335.6	NM	NM	NM	NM	NM	-65
VERITAS SOFTWARE VRTS	374.4	1	1492.3	24	-204.3	NM	-651.4	NM	NM	NM	-22.9	NM	-1
19 PAPER & FOREST PRODUCTS													
INDUSTRY COMPOSITE	21007.3	-7	89470.8	-2	-615.0	NM	-856.7	NM	NM	NM	-2.6	NM	-0.0
(A) FOREST PRODUCTS													
GROUP COMPOSITE	6902.3	4	30071.0	9	-24.8	NM	-335.9	NM	NM	NM	-4.6	NM	-0.8
GEORGIA-PACIFIC GP	5790.0	5	25016.0	13	34.0	NM	-255.0	NM	0.6	NM	-4.9	NM	-1.3
LOUISIANA-PACIFIC LPX	515.9	-9	2359.7	-20	-70.8	NM	-171.6	NM	NM	NM	-15.9	NM	-1.4
RAYONIER RYN	267.1	-11	1164.9	-5	7.9	-40	57.6	-26	3.0	4.4	13.2	23	2
UNIVERSAL FOREST PRODUCTS UFP	329.3	17	1530.4	10	4.1	25	33.1	9	1.3	1.2	12.4	14	1
(B) PAPER													
GROUP COMPOSITE	14105.1	-12	59399.8	-6	-590.2	NM	-520.8	NM	NM	0.4	-2.1	NM	-0.5
BOISE CASCADE BCC	1756.7	-6	7422.2	-5	-41.7	NM	-42.5	NM	NM	1.3	-3.4	NM	-0.9
BOWATER BOW	700.3	8	2449.2	-2	18.7	-68	73.2	-54	2.7	8.0	8.6	33	1.3
INTERNATIONAL PAPER IP	6254.0	-13	26363.0	-6	-572.0	NM	-1142.0	NM	NM	NM	-11.1	NM	0.2
MEAD MEA	934.9	-11	4176.5	-4	-25.9	NM	-12.3	NM	NM	1.6	-0.5	84	-0.0
WEYERHAEUSER WY	3398.0	-16	14535.0	-9	-15.0	NM	354.0	-58	NM	4.8	5.2	86	1.6
WILLAMETTE INDUSTRIES WLL	1061.2	-6	4453.9	-4	45.6	-47	248.8	-28	4.3	7.6	9.8	25	2.2
20 PUBLISHING & BROADCASTING													
INDUSTRY COMPOSITE	20830.1	-5	76670.9	1	165.1	-88	1717.0	-69	0.8	5.0	2.6	NM	0.3
(A) BROADCASTING													
GROUP COMPOSITE	11452.4	1	40730.9	3	71.0	-93	471.2	-84	0.6	8.8	1.1	NM	0.1
COMCAST CMCSK	2824.1	17	9674.2	18	-321.0	NM	225.6	-89	NM	32.5	1.6	NM	0.2
DISNEY (WALT) DIS ⁽³⁾	7048.0	-5	24884.0	-4	138.0	11	316.0	-63	6.2	3.3	1.4	NM	0.1
UNIVISION COMMUNICATIONS UVN	233.8	-2	187.9	3	10.9	-69	54.7	-53	4.7	14.7	6.9	NM	0.2
USA NETWORKS USAI	1346.5	8	5284.8	15	-56.9	NM	-125.1	NM	NM	NM	-3.1	NM	-0.9
(B) PUBLISHING													
GROUP COMPOSITE	9385.8	-11	35939.9	-2	94.2	-71	1245.8	-54	1.0	3.1	5.5	55	0.7
DOW JONES DJ	431.5	-23	1773.1	-20	2.1	NM	68.2	NM	0.5	NM	142.3	67	0.7
GANNETT GCI	1624.1	-14	6344.2	2	248.4	-16	831.2	-14	15.3	15.3	15.1	22	3.1
KNIGHT-RIDDER KRI	733.3	-16	2900.2	-10	75.0	NM	184.8	-41	10.2	NM	11.7	29	2.1
McCLATCHY MNI	276.7	-11	1080.1	-5	20.9	-22	55.0	-35	7.6	8.8	6.9	41	1.2

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COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDED 12-31	PRICE-EARNINGS RATIO 2-7	MO. EST. F.S.
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
McGraw-Hill MHP	1114.6	3	4645.5	8	-2.8	NM	377.0	-20	NM	NM	10.3	34	1
Meredith MDP (6)	229.8	-12	1010.9	-7	8.7	-64	48.1	-29	5.8	9.2	11.0	50	0
New York Times NYT	780.6	-16	3016.0	-11	74.1	-46	202.2	-48	9.5	14.8	17.4	34	1
PRIMEA PRM	451.4	-2	1742.3	8	-608.3	NM	-1111.6	NM	NM	NM	NM	NM	-5
Reader's Digest Association RDA (6)	784.0	-5	2423.9	-5	78.8	-24	83.7	-46	10.1	12.6	19.3	25	0
Scholastic SCHL (7)	637.2	-5	1875.2	8	66.5	18	25.3	-68	10.4	8.4	4.7	NM	0
SCRIPPS (E.W.) SSP	375.0	-18	1458.5	-15	9.5	-80	138.0	-16	2.5	10.5	10.3	NM	1
TRIBUNE TRIB	1317.9	-13	5253.4	8	106.8	100	111.1	-64	8.1	2.6	1.6	NM	0
WASHINGTON POST WPO	629.6	-6	2416.7	0	14.5	-61	229.6	82	2.3	5.6	13.8	23	24
21 SERVICE INDUSTRIES													
INDUSTRY COMPOSITE	39373.2	6	155360.4	8	-226.0	NM	2477.4	-45	NM	3.0	6.0	49	0
(A) CONSTRUCTION & ENGINEERING													
GROUP COMPOSITE	6627.2	71	24114.4	55	-230.5	NM	187.8	-57	NM	3.1	4.2	47	0
FLUOR FLR	2635.0	NM	8972.2	NA	31.4	NM	127.8	NA	1.2	NA	16.3	18	1
FOSTER WHEELER FWC	996.3	-6	3314.6	-15	-273.3	NM	-263.1	NM	NM	1.2	-71.8	NM	-6
INTEGRATED ELECTRICAL SERVICES IEE (3)	375.2	-12	1641.4	-7	-1.8	NM	19.9	-22	NM	1.6	8.1	8	0
JACOBS ENGINEERING GROUP JEC (3)	1028.2	11	4056.0	15	25.9	29	93.5	22	2.5	2.2	15.3	18	3
PERINI PCR	362.5	8	1553.4	40	6.4	-13	26.4	8	1.8	2.1	30.7	6	1
REPUBLIC SERVICES RSG	563.5	7	2257.5	7	-38.9	NM	125.5	-43	NM	10.7	7.0	23	0
URS URS (2)	666.5	11	2319.4	5	19.8	24	57.9	16	3.0	2.7	13.1	12	2
(B) INDUSTRIAL DISTRIBUTION													
GROUP COMPOSITE	8367.0	-17	34674.4	-8	97.8	-47	166.0	-80	1.2	1.8	2.4	NM	0
ADVANCED MARKETING SERVICES MKT (9)	267.1	8	720.4	3	13.3	16	22.8	11	5.0	4.6	17.8	16	1
AIRGAS ARG (9)	392.4	-1	1634.9	1	11.8	77	41.2	50	3.0	1.7	8.5	29	0
APPLIED INDUSTRIAL TECHNOLOGIES AIT (6)	347.6	-14	1515.0	-9	2.9	-60	21.3	-37	0.8	1.8	7.2	16	1
AUDIOVOX VOXX (1)	345.8	-33	1267.7	-26	-2.3	NM	-7.0	NM	NM	0.6	-2.2	NM	-0
AVNET AVT (6)	2359.9	-35	10555.9	-17	-2.6	NM	-186.0	NM	NM	2.3	-7.9	NM	-1
KNIGHTPOINT KELL	408.7	-21	1825.2	-8	-46.3	NM	-57.6	NM	NM	1.4	-38.7	NM	-1
FISHER SCIENTIFIC INTERNATIONAL FSH	754.7	17	2880.0	10	11.0	NM	16.4	-28	1.5	NM	70.4	87	0
GRANGER (W.W.) GWW	1110.5	-8	4754.3	-4	61.5	28	174.5	-10	5.5	4.0	11.1	29	1
PATTERSON DENTAL PDCO (8)	355.0	22	1254.0	14	23.3	23	84.3	20	6.6	6.5	18.5	33	1
PIONEER-STANDARD ELECTRONICS PIOS (9)	633.7	-19	2543.0	-11	2.2	-83	-0.7	NM	0.4	1.7	-0.2	NM	-0
PSS WORLD MEDICAL PSSI (9)	455.3	1	1798.0	-1	3.4	NM	-0.2	NM	0.7	NM	-0.1	NM	-0
UNITED STATIONERS USTR	936.3	-5	3925.9	0	19.5	-24	57.0	-42	2.1	2.6	10.6	22	1
(C) PRINTING & ADVERTISING													
GROUP COMPOSITE	2300.8	-11	8795.1	-6	11.1	-91	202.8	-56	0.5	4.9	10.4	33	0
ADVO AD (3)	286.9	-4	1126.6	-2	12.1	-19	48.1	-7	4.2	5.0	NM	16	2
HARTA HW	366.0	-13	1452.8	-2	16.1	-5	50.0	-15	4.4	4.0	12.6	16	2
DONNELLEY (R.R.) DNY	1414.8	-12	5297.8	-8	-37.7	NM	25.0	-91	NM	4.5	2.5	NM	0
HARTE-HANKE HHS	233.0	-9	917.9	-4	20.6	-5	79.7	-3	8.8	8.4	14.4	23	1
(D) OTHER SERVICES													
GROUP COMPOSITE	22078.2	7	87776.4	6	-104.4	NM	1920.8	-32	NM	3.3	6.9	45	0
ABM INDUSTRIES ABM (2)	496.7**	4	1950.0	8	-0.9	NM	32.8	-26	NM	3.0	9.0	23	1
APOLLO GROUP APOL (4)	228.2	29	820.6	27	33.0	83	115.9	86	14.4	14.0	22.9	NM	0
AUTONATION AN	5145.9	10	19989.3	-3	19.6	-73	245.0	-25	0.4	1.6	6.3	13	0
CARMAX GROUP KMX (10)	774.3	35	3062.5	29	18.4	144	80.2	122	2.4	1.3	17.1	33	0
CASEY'S GENERAL STORES CASY (8)	558.5*	12	2039.0	8	12.4	-10	30.5	-27	2.2	2.8	8.4	24	0
CENDANT CD	2580.0	121	8950.0	92	-307.0	NM	423.0	-36	NM	12.4	6.0	36	0
CERTEGY CEY	232.7	9	851.1	9	26.5	1	87.1	-2	11.4	12.3	54.5	28	1
CINTAS CTAS (7)	557.1	8	2221.4	9	85.0	8	229.6	10	10.4	10.5	17.1	37	1
CONVERGYS CVG	590.7	-1	2320.6	6	56.4	8	138.8	-27	9.5	8.8	11.3	40	0
GARTNER IT.B (3)	247.2	-3	943.6	5	19.0	8	1.1	-98	7.7	8.9	NM	NM	-0
HANDLEMAN HDL (8)	355.2	19	1280.3	11	15.7	11	43.9	9	4.4	4.8	16.2	7	1
KELLY SERVICES KELYA	1037.1	-10	4256.9	-5	0.7	-97	16.5	-81	0.1	2.0	2.7	47	0
KPMG CONSULTING KCIN (6)	593.2	-16	2675.9	0	6.6	NM	20.9	NM	1.1	NM	-8.9	NM	-0
MANPOWER MAN	2536.4	-7	10483.8	-3	26.0	51	124.5	-27	1.0	2.0	18.3	20	1
MPS GROUP MPS	325.6	-28	1548.5	-15	-2.7	NM	8.3	-93	NM	1.7	0.6	NM	0
PANTRY PTRY (3)	577.4*	-9	2586.2	0	0.5	-75	-4.1	NM	0.1	0.3	-3.7	NM	-0
PAYCHEX PAYX (7)	480.2	15	1871.4	16	68.7	11	273.0	23	14.3	14.9	32.2	NM	0
QUINTILES TRANSNATIONAL QTRN	404.0	-1	1619.9	-2	72.6	993	-175.9	NM	12.0	1.6	-12.4	NM	-1
REGIS RGIS (6)	358.5	11	1385.0	13	17.0	40	60.6	10	4.7	3.7	16.2	18	1
ROBERT HALF INTERNATIONAL RHI	510.5	-28	2452.9	-9	12.7	-73	121.1	-35	2.5	5.8	16.0	36	0
SERVICEMASTER SVM	837.7	5	3601.4	8	-269.6	NM	-171.8	NM	NM	4.0	-14.5	NM	-0
SPHERION SPN	590.7	-34	2713.1	-27	-5.4	NM	108.1	83	NM	NM	8.3	5	1
UNITED AUTO GROUP UAG	1614.7	30	6220.7	27	11.3	84	44.7	32	0.7	0.5	7.2	16	1
VOLT INFORMATION SCIENCES VOL (2)	445.7	-26	1932.3	-9	6.1	-38	6.7	-79	1.4	1.6	2.5	84	0

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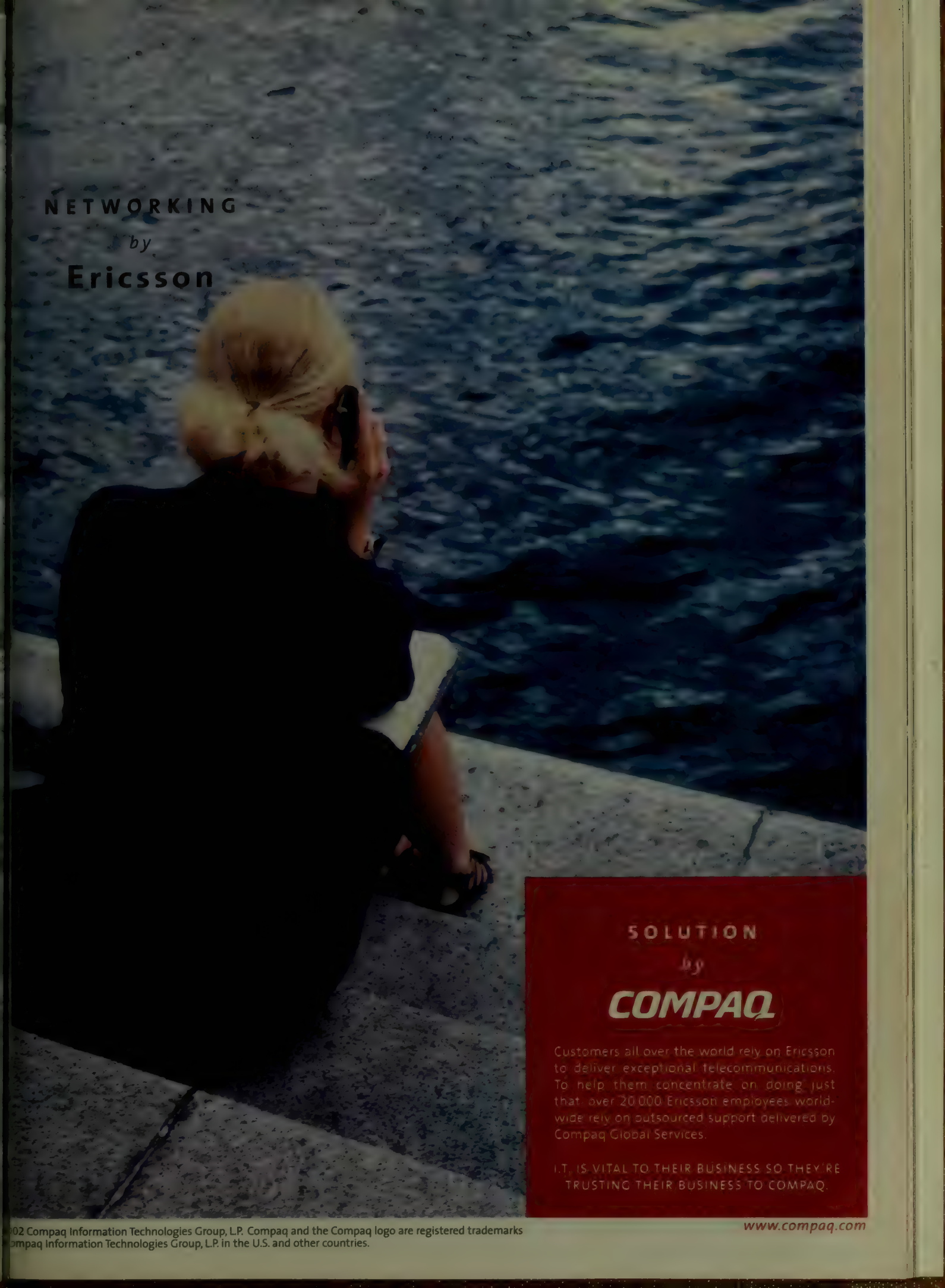
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COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12-MONTH ENDING 12-31	FINANCIAL RATIOS 2-7	MO. EARLY FISCAL START
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
22 TELECOMMUNICATIONS													
INDUSTRY COMPOSITE	82871.0	-6	341989.5	-2	-10323.2	NM	-24995.7	NM	NM	2.4	-9.3	NM	-0.0
(A) EQUIPMENT & SERVICES													
GROUP COMPOSITE	40546.9	-10	175069.1	-4	-9853.9	NM	-32232.0	NM	NM	NM	-20.0	NM	-1.0
ADC TELECOMMUNICATIONS A. T. (2)	391.6	-62	2402.8	-27	-176.9	NM	-1287.7	NM	NM	0.4	-68.0	NM	-1
AT&T	12586.0	-10	52550.0	-5	-1391.0	NM	-4131.0	NM	NM	NM	-14.5	NM	-1
AT&T WIRELESS SERVICES AWE †	3528.0	19	13610.0	30	-355.0	NM	200.0	-76	NM	16.4	0.6	NM	0
CENTURYTEL CTL	543.1	11	2117.5	15	49.8	-13	343.0	10	9.2	10.0	15.0	13	2
Ciena CEN (2)	367.8	27	1603.2	87	-1802.3	NM	-1794.1	NM	NM	9.0	-84.3	NM	-5
CONVERSE TECHNOLOGY CMVT (11)	295.0	-7	1351.7	20	1.7	-97	185.5	-17	0.6	20.2	11.1	17	1
CORNING GLW	974.0**	-53	6272.0	-12	-655.0	NM	-5498.0	NM	NM	NM	NM	NM	-5
IDT IDT (5)	339.2	23	1293.6	19	-11.3	NM	-348.5	NM	NM	NM	-20.0	NM	-4
LEVEL 3 COMMUNICATIONS LVLT	326.0	-25	1533.0	29	-3717.0	NM	-5448.0	NM	NM	NM	NM	NM	14
LUCENT TECHNOLOGIES LU (3)	3579.0	-18	20527.0	-22	-423.0	NM	-13018.0	NM	NM	NM	NM	NM	-3
MCI GROUP MCTT	3177.0	-16	13831.0	-15	-89.0	NM	-23.0	NM	NM	3.3	-1.0	NM	-0
SCIENTIFIC-ATLANTA SFA (6)	418.2	-34	2111.6	-5	39.2	-45	225.9	-20	9.4	11.2	16.2	16	1
SPRINT FON GROUP FON	4012.0	-9	16924.0	-4	-906.0	NM	-146.0	NM	NM	2.2	-1.2	NM	-0
SPRINT PCS GROUP PCS	2759.0	42	9725.0	53	-321.0	NM	-1249.0	NM	NM	NM	NM	NM	-1
TELEPHONE & DATA SYSTEMS TDS	670.9	12	2588.5	11	86.0	23	-168.2	NM	12.8	3.7	-4.8	NM	-2
TELLABS TLAB	470.0	-59	2199.7	-35	-80.3	NM	-182.0	NM	NM	25.0	-7.4	NM	-0
U.S. CELLULAR USM	478.7	0	1894.8	10	33.0	-12	180.8	-23	6.9	8.6	7.7	18	2
WILLIAMS COMMUNICATIONS GROUP WCG	330.3	15	1185.5	41	-440.8	NM	-1480.7	NM	NM	NM	-98.6	NM	-3
WORLDCOM GROUP WCOM	5301.0	-10	21348.0	-6	305.0	-48	1407.0	-46	5.8	10.0	2.5	16	0
(B) TELEPHONE COMPANIES													
GROUP COMPOSITE	42324.1	-1	166920.4	-1	-469.2	NM	7236.3	-70	NM	9.3	5.7	48	0.0
ALLTEL AT	1926.8	1	7598.9	5	231.4	-12	1047.5	-47	12.0	13.8	18.0	16	3
BELLSOUTH BLS	6213.0	1	24130.0	-8	792.0	-29	2570.0	-39	12.7	18.2	13.8	28	1
BROADWING BRW	566.3	1	2350.5	15	-195.6	NM	-286.2	NM	NM	NM	-17.0	NM	-1
QWEST COMMUNICATIONS INTL. Q	4704.0	-6	19743.0	19	-516.0	NM	-3945.0	NM	NM	NM	-10.8	NM	-2
SBC COMMUNICATIONS SBC	11903.0	-2	45908.0	-11	1245.0	-4	7260.0	-9	10.5	10.6	22.3	10	0
VERIZON COMMUNICATIONS VZ †	17011.0	1	67190.0	11	-2026.0	NM	590.0	-95	NM	10.1	1.8	NM	0
23 TRANSPORTATION													
INDUSTRY COMPOSITE	49493.4	-12	213578.8	-5	-1847.8	NM	-1949.6	NM	NM	2.6	-2.7	NM	-0.0
(A) AIRLINES													
GROUP COMPOSITE	17251.4	-28	87179.5	-11	-3325.6	NM	-7361.5	NM	NM	NM	-39.9	NM	-5.0
ALASKA AIR GROUP ALK	462.2	-13	2140.9	-2	-36.4	NM	-39.5	NM	NM	NM	-4.6	NM	-1
AMERICA WEST HOLDINGS AWA	399.9	-30	2065.9	-12	-60.9	NM	-147.9	NM	NM	NM	-28.3	NM	-4
AMR AMR	3804.0	-22	18963.0	-4	-798.0	NM	-1762.0	NM	NM	1.0	-28.3	NM	-11
AMTRAN AMTR	247.6	-14	1275.5	-1	-78.9	NM	-76.3	NM	NM	NM	NM	NM	-7
CONTINENTAL AIRLINES CAL	1738.0	-28	8969.0	-9	-149.0	NM	-95.0	NM	NM	1.8	-7.6	NM	-1
DELTA AIR LINES DAL	2863.0	-29	13879.0	-17	-734.0	NM	-1216.0	NM	NM	0.4	132.6	NM	-9
NORTHWEST AIRLINES NWAD	1985.0	-27	9905.0	-12	-216.0	NM	-423.0	NM	NM	NM	NM	NM	-5
SOUTHWEST AIRLINES LUV	1237.6	-16	5555.2	-2	63.5	-59	511.1	-18	5.1	10.5	12.7	30	0
UAL UAL	2949.0	-38	16138.0	-17	-308.0	NM	-2137.0	NM	NM	NM	-69.1	NM	-39
US AIRWAYS GROUP U	1565.0	-34	8288.0	-11	-1008.0	NM	-1976.0	NM	NM	NM	NM	NM	-29
(B) RAILROADS													
GROUP COMPOSITE	8846.0	0	35461.0	0	632.0	34	2358.0	8	7.1	5.3	8.0	18	1.8
BURLINGTON NORTHERN SANTA FE BNI	2301.0	-2	9208.0	0	177.0	-31	737.0	-25	7.7	10.9	9.4	15	18
CSX CSX	2009.0	-2	8110.0	-1	65.0	20	293.0	58	3.2	2.6	1.8	27	1
NORFOLK SOUTHERN NSC	1530.0	0	6170.0	0	115.0	NM	362.0	110	7.5	0.3	6.0	22	0
UNION PACIFIC UNP	3006.0	2	11973.0	1	275.0	75	966.0	15	9.1	5.3	10.1	15	3
(C) TRANSPORTATION SERVICES													
GROUP COMPOSITE	10621.3	-2	42173.9	0	55.9	-71	232.5	-80	0.5	1.8	2.0	NM	0.0
AIRBORNE ABF	802.6	-5	3211.1	-2	2.2	NM	-19.5	NM	0.3	NM	-2.3	NM	-0
ATLAS AIR WORLDWIDE HOLDINGS AGO	283.8	27	763.8	-3	-8.1	NM	-61.3	NM	NM	13.9	-12.3	NM	-1
CNF CNF	1142.7	-21	4862.7	-13	-215.0	NM	-433.6	NM	NM	2.8	-51.2	NM	-9
FEDEX FDX (7)	5135.0	5	20127.4	8	245.0	26	590.9	-18	4.8	4.0	9.5	26	1
GATX GMT †	346.1	-4	1488.6	13	-12.1	NM	7.5	-76	NM	NM	0.9	NM	0
PITTSBURGH PZB	947.1**	-5	3624.2	-5	24.1	NM	45.8	NM	2.5	NM	9.0	26	0
ROBINSON (C.H.) WORLDWIDE CHRW	776.4	6	3090.1	7	20.6	11	84.0	16	2.7	2.5	23.6	29	0
RYDER SYSTEM R	1187.7	-12	5006.1	-6	0.2	-99	18.7	-79	0.0	2.0	1.5	82	0
(D) TRUCKING & SHIPPING													
GROUP COMPOSITE	12774.7	0	48764.4	0	788.9	-10	2821.4	-20	6.2	6.6	19.9	25	1.5
ALEXANDER & BALDWIN ALEX	356.1**	56	1190.1	11	54.1	272	119.8	53	15.2	5.6	16.7	8	2
ARKANSAS BEST ABFS	337.5	-23	1526.2	-17	9.5	-57	41.4	-46	2.8	5.0	11.5	15	1
HUNT (J.B.) TRANSPORT SERVICES JBHT	545.5	2	2099.6	-3	18.2	67	32.9	-9	3.3	2.0	7.3	25	0



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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINE		RETURN ON EQUITY 12-MONTH ENDING	PRICE- EARNINGS RATIO 2-7	M- EAT
	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	12 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	4TH QUARTER 2001 %	4TH QUARTER 2000 %			
LANDSTAR SYSTEM LSTR	347.8	-9	1392.8	-2	11.6	-27	42.8	-5	3.3	4.2	16.4	16	
ROADWAY ROAD	867.5	-9	2791.7	-8	13.7	-46	30.8	-45	1.6	2.7	8.6	21	
SWIFT TRANSPORTATION SWFT	530.7	■	2112.2	7	13.0	13	27.2	-61	2.5	2.2	1.9	100	
UNITED PARCEL SERVICE UPS	8089.0	2	30646.0	3	645.0	-11	2425.0	-17	8.0	9.2	25.0	106	
USFREIGHTWAYS USFC	594.8	-8	2458.6	-3	8.8	-61	38.4	-60	1.5	3.5	5.7	23	
WERNER ENTERPRISES WERN	320.5	3	1270.5	5	13.7	10	47.7	-1	4.3	4.0	8.1	106	
YELLOW YELL	785.3	-11	3276.7	-9	1.4	-91	15.3	-78	0.2	1.8	5.1	34	

24 UTILITIES & ENERGY SERVICES

INDUSTRY COMPOSITE	130109.3	-13	605463.5	31	2904.2	-30	22251.0	4	2.2	2.8	11.7	14	2
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(A) ELECTRIC, WATER & COGENERATION

GROUP COMPOSITE	100658.1	-8	466261.5	34	1849.4	-40	19466.0	10	1.8	2.8	12.1	13	2
AES AES +	2387.0	25	9327.0	24	190.0	-20	467.0	-44	8.0	12.4	8.0	12	
ALLEGHENY ENERGY AVE	2063.2	59	10378.9	159	65.8	-19	454.0	42	3.2	6.6	15.6	9	
ALLETE ALE	351.4	11	1452.9	31	24.7	45	128.6	-6	7.0	5.3	11.2	17	
ALLIANT ENERGY LNT	646.5	-8	2777.3	15	67.9	9	192.0	-51	10.5	8.9	11.6	13	
AMEREN AEE	992.7	11	4505.9	17	52.0	78	488.8	■	5.2	3.3	14.2	12	
AMERICAN ELECTRIC POWER AEP	14200.0	30	61300.0	67	54.4	NM	1003.7	232	0.4	NM	12.0	13	
AMERICAN WATER WORKS AWW	363.6	■	1438.9	7	32.9	-14	161.5	0	9.0	11.5	9.2	27	
AVISTA AVA	1037.3	-55	6025.9	-24	9.6	-87	73.8	-27	0.9	3.1	9.7	9	
BLACK HILLS BRH	275.4	-53	1558.6	-4	4.8	-75	88.1	67	1.7	3.3	17.5	8	
CALPINE CPN	1721.5	57	7581.2	201	104.2	-23	652.6	75	6.1	12.3	22.6	4	
CINERGY CIN	2250.3	-19	12922.5	53	111.5	20	445.7	10	5.0	3.4	15.0	12	
CONNECTICUT CT	953.4	-26	5790.1	16	15.5	-65	396.7	77	1.6	3.5	29.9	6	
CONSOLIDATED EDISON ED	1942.6	-14	9634.0	2	128.5	160	695.8	17	6.6	2.2	12.0	13	
CONSTELLATION ENERGY GROUP CEG	901.9	-12	3928.3	2	-256.8	NM	95.6	-73	NM	8.7	2.0	53	
DOMINION RESOURCES D	2507.0	-10	10558.0	14	-117.0	NM	544.0	25	NM	3.8	7.2	27	
DPL DPL	257.1	-15	1199.6	-8	32.5	-80	215.5	-24	12.6	5.6	25.7	13	
DQE DQE	310.7	-8	1296.1	-2	-66.6	NM	-153.4	NM	NM	6.6	-25.8	NM	-2
DUKE ENERGY DUK	10714.0	-30	59503.0	21	225.0	-21	1994.0	12	2.1	1.8	15.8	13	
ENERGY EAST EAS	840.8	-20	3759.8	27	67.0	24	189.5	-20	8.0	5.1	10.8	12	
ENTERGY ETR	1885.3	-28	9620.9	-4	3.1	-94	727.0	2	0.2	1.9	9.4	13	
EXELON EXD	3381.0	■	15140.0	102	338.0	235	1416.0	150	10.0	1.5	18.4	11	
FIRSTENERGY FE	2257.8	24	7999.4	14	190.2	37	727.0	10	5.4	7.6	13.3	14	
FPL GROUP FPL	1839.0	-1	8475.0	20	122.0	74	797.0	11	6.6	3.8	13.1	11	
GREAT PLAINS ENERGY GXP	354.2	43	1461.9	31	-128.8	NM	-40.0	NM	NM	8.0	-4.5	NM	-0
HAWAIIAN ELECTRIC INDUSTRIES HE	419.3	-9	1727.3	0	25.7	17	109.8	-1	6.1	4.7	12.2	13	
IDACORP IDA	821.0	-22	5648.0	109	21.0	-16	130.0	-11	2.6	2.4	14.4	12	
MIRANT MIR	7242.0	-9	31537.0	137	30.0	-50	563.0	70	0.4	0.8	12.0	6	
MISOURCE MI	2029.4	-26	9458.7	57	67.2	NM	219.6	47	3.3	NM	6.2	NM	1
NORTHEAST UTILITIES NU	1766.2	18	6873.9	17	51.4	-8	273.5	25	2.9	3.7	12.6	9	
NORTHWESTERN NWR	797.4	-69	4237.8	-41	3.2	-77	37.7	-14	0.4	0.6	11.3	14	
NRG ENERGY NRG +	667.6	-2	2805.4	39	39.3	-6	265.2	45	5.9	6.2	12.2	7	
NSTAR NST	706.2	2	3194.0	19	29.1	-35	3.2	-98	4.1	6.4	-0.2	NM	-0
OGE ENERGY OGE	543.1	-45	3182.4	-4	-6.3	NM	100.6	-32	NM	0.7	9.2	17	
PINNACLE WEST CAPITAL PNW	744.7	-11	4551.4	23	35.8	-15	327.4	8	2.0	5.0	13.1	11	
PNM RESOURCES PNM	327.6	-29	2352.1	46	4.5	-68	150.4	40	1.4	3.1	14.9	7	
POTOMAC ELECTRIC POWER POM	506.2	-14	2473.6	-4	-15.9	NM	168.4	-52	NM	27.7	9.0	15	
PPL PPL	1312.0	-13	5725.0	1	-305.0	NM	221.0	-57	NM	8.2	9.1	28	
PROGRESS ENERGY PGN	1907.2	■	8461.5	106	-90.5	NM	541.6	13	NM	NM	9.0	17	
PUBLIC SERVICE ENTERPRISE GROUP PEG	2424.0	-8	9815.0	■	195.0	-8	763.0	-1	8.0	10.0	18.6	11	
RGS ENERGY GROUP RGS	348.5	-20	1530.5	6	13.5	-43	73.0	-24	3.9	5.4	8.9	20	
SOUTHERN SO	2159.0	-6	10155.0	1	120.6	75	1138.0	12	5.6	3.0	14.0	15	
TECO ENERGY TE	657.8	11	2648.6	15	64.8	12	303.7	21	9.9	9.7	16.2	11	
TXU TXU	6822.0	■	27927.0	27	86.0	-48	843.0	-9	1.3	2.4	10.1	16	
UIL HOLDINGS UIL	267.5	14	1085.8	23	9.7	■	59.4	-2	3.6	2.7	11.9	13	
UNISOURCE ENERGY UNS	324.8	17	1444.7	40	13.3	-3	60.9	45	4.1	5.0	14.7	9	
UTILICORP UNITED UCU	8639.9	-19	40376.8	■	-6.2	NM	279.4	■	NM	0.5	10.7	9	
WISCONSIN ENERGY WEC	892.3	-20	3928.5	17	37.2	■	208.5	■	4.2	2.6	10.1	13	
WPS RESOURCES WPS	583.8	-19	2675.5	37	21.3	■	80.7	15	3.6	2.0	12.5	14	
XCEL ENERGY XEL	3314.8	-10	14811.1	30	134.6	-2	784.7	44	4.1	3.7	12.6	10	

(B) GAS, OIL & ENERGY SERVICES

GROUP COMPOSITE	29451.2	-25	139202.0	22	1054.8	-4	2785.0	-23	3.6	2.8	9.5	20	1
AGL RESOURCES ATG (3)	325.7	10	1080.2	50	29.4	23	104.8	27	9.0	8.1	13.2	13	
DYNEGY DYN	8743.0	-13	42242.0	43	77.0	-27	646.0	■	0.9	1.1	15.6	11	
EL PASO EP	12115.0	-26	57475.0	18	375.0	■	67.0	-95	3.1	2.2	0.8	NM	0

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Quotes, Level II³

No

None

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+3¢/share over 1,000

Quotes⁴, Level II, News, Charts, Time & Sales⁵

No

None

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2 Only Power E-TRADE customers making 30+ trades per quarter are eligible for Level II quotes and watch lists. Only E-TRADE Pro customers making 75+ trades per quarter are eligible for streaming charts

3 Only Powerstreet Pro customers making 72+ trades in a rolling 12-month period are eligible for streaming quotes and Level II quotes.

4 Only Signature Services Platinum customers are eligible for streaming quotes.

5 Only Signature Services Platinum customers who have made 120+ commissionable trades in the past year are eligible for Level II quotes, streaming news, charts, and time and sales.

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ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

Gtech Holdings 18c
Guidant 12d

H

Halliburton 11b
Handelman 21d
Harley-Davidson 14d
Harman International 6b
Harrah's Entertainment 14b
Harris 9b
Harsco 15a
Harte-Hanks 21c
Hartford Financial Services 17b
Hasbro 14d
Hawaiian Electric 24a
HCA 12c
Health Management Assocs. 12c
Heinz (H.J.) 10b
Hercules 4
Hershey Foods 10b
Hewlett-Packard 18b
Hewlett 15a
Hibernia 3c
Hilton Hotels 14c
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Hovnanian Ents. 13b
HUBBARD 9a
Hughes Electronics 9b
Hughes Supply 13a
Humana 12c
Hunt (J.B.) 23d
Huntington Bancshares 3b

I

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Idacorp 24a
IDT 22a
IKON Office Solutions 5
Illinois Tool Works 15c
Imation 18c
IMC Global 4
Immunex 12b
Ingles Markets 10c
Insight Enterprises 8
Integrated Electrical Svcs. 21a
Intel 9d
International Flavors 4
International Game Tech. 15a
Intl. Multifoods 10a
International Paper 19b
Interstate Bakeries 10b
Intimate Brands 8
Invacare 12d
Isle of Capri Casinos 14b
ITT Industries 15c
J.P. Morgan Chase 3a
Jabil Circuit 9d
Jacobs Engineering 21a
JDS Uniphase 9d
Jefferson-Pilot 17b
Jo-Ann Stores 8
John Hancock Financial 17b
Johnson & Johnson 12d
Johnson Controls 15a
Jones Apparel Group 6a
Jones Lang LaSalle 13b
Joy Global 15c

K

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Kellwood 6a
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Kimberly-Clark 6d
Kinder Morgan 24b
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Kohl's 8
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Kroger 10c

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Longs Drug Stores 12a
Louisiana-Pacific 19a
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MDU Resources Group 24b
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Monsanto 4
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Noble Drilling 11b
Nordstrom 8
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Northern Trust 3b
Northrop Grumman 1
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NSTAR 24a
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NUI 24b
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Owens Corning 13a

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P

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Pactiv 7b
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Ralcorp Holdings 10b
Raymond James Finl. 17a
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RGS Energy Group 24a
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Rockwell Collins 1
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Russell 6a
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Sears, Roebuck 8
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Siebel Systems 18c
Sierra Health Services 12c
Silgan Holdings 7a
Silicon Graphics 18b
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Sybase 18c
Symantec 18c
Synovus Financial 3c
Sysco 10a

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Target 8
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Tribble 22a
Temple-Inland 7b
Tenet Healthcare 12c
Tenneco Automotive 2b
Terra Inds. 4
Tesoro Petroleum 11a
Texas Industries 15a
Texas Instruments 9d
Tetra 5
Tiffany 8
Timberland 6a
Timken 15c
TSCM 18c
3M 15a
TJX 8
Toll Brothers 13b
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Toro 15c
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Trans World Entertainment 14d
Transatlantic Holdings 17b
Transocean Sedco Forex 11b
Tribune 20b
TRW 5
Tupperware 15a
Twister Home Ent. 6b
TXU 24a
Tyco Intl. 5
Tyson Foods 10b

U

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U.S. Cellular 22a
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UIL Holdings 24a
Union Pacific 23b
Union Planters 3c
UnionBank 3d
Unisource Energy 24a
Unisys 18b

United Auto Group 21d
United Defense Inds. 14d
United Natural Foods 18a
United Parcel Service 23d
United States Steel 18a
United Stations 21b
United Technologies 1
UnitedHealth Group 12c
Univis 17b
Universal Forest Products
Univision Communs. 20a
Unocal 11a
UnumProvident 17b
URS 21a
US Airways Group 33a
USA Education 17a
USA Networks 20a
USEC 4
USFreightways 23d
USO 13a
UST 6c
UTC Corp. United 24a

V

Valero Energy 11a
Valstar 13a
Value City 8
Vanco International 17b
Vectren 24b
VerSign 18c
Veritas Software 18c
Verizon Communications 2
Viac 5
Viasystems Group 9d
Vishay Intertechnology 9d
Visbeck 2b
Vot Info. Sciences 21d
Vulcan Materials 13a

W

Waltham 3c
Walgreen 12a
Wallace Computer 18a
Wal-Mart Stores 8
Waller Industries 5
Washington Mutual 17c
Washington Post 20b
Waters 3c
Weatherford Intl. 11b
Weis Markets 10c
Wells Fargo 3b
Werner Enterprises 23d
Westcorp 17c
Western Digital 18b
WestPoint Stevens 15d
Westvaco 7b
Weyerhaeuser 19b
WGL Holdings 24a
Whisper 6b
Williamette Industries 19b
Williams Communications 2a
Williams-Sonoma 6b
Winn-Dixie Stores 10c
Wisconsin Energy 24a
World Fuel Services 24d
WorldCom Group 22a
Worthington Inds. 16a
WP Resources 24a
Wright (Wm.) Jr. 10b
Wyndham International 14c

X Y Z

Xcel Energy 24a
Xerox 18b
Xerox 9d
Yellow 23d
Zale 8
Zimmer Holdings 12d
Zions Bancorporation 3d

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S&P 500 INDEX

Monthly closing prices
Jan. 1998–Jan. 2002

Data: Economy.com, BusinessWeek

AUGUST 1998

Emerging-
markets
meltdown;
Dow falls 512
points on
Aug. 31.
S&P drops to
957.28

SEPTEMBER 1998

Long-Term
Capital
Management
bailed out

MARCH 2000

Nasdaq hits
high of
5048.62 on
Mar. 3.
S&P peaks
Mar. 24 at
1527.46

APRIL 2000

Microsoft
found guilty of antitrust
violation
Apr. 5

THE ROAD TO DISILLUSIONMENT

Investors were true believers in equities until March, 2000. Then a barrage of shocks undermined their faith



It's 2 a.m., and Jim Tucci is staring wide-eyed at the ceiling—another sleepless night. Instead of counting sheep, he's anxiously tallying up how much he has lost in the stock market. Half of his \$400,000 nest egg, he figures, has evaporated in just two years. Forget the retirement property on the Gulf Coast. Forget the long-planned trip to Italy with his wife. Tucci, a 60-year-old sales manager at a voice-recording company in Boston, admits he blew a wad on speculative tech stocks during the Internet bubble. But a year ago, he dove for safety in blue-chip stocks like IBM, Merrill Lynch, General Motors, and Delta Air Lines. Now, 40% of that is gone. Tucci feels suckered. "I'm paralyzed. I can't sell because I'd take such a big loss. I'm sure as heck not going to buy anything. And even if I were, who would I listen to for advice? No one seems to even give off a whiff of honesty about any of this stuff. These days, I just pray a lot."

THE BETRAYED INVESTOR

Cover Story

Some 100 million investors—about half of all adult Americans—can relate to that. They're the new Investor Class that has emerged over the past decade. Predominantly middle-class, suburban baby boomers, they bought into the idea that stocks could only make them richer. They exulted during the long bull market of the 1990s. But they've lost \$5 trillion, or 30%, of their stock wealth since the spring of 2000, when the dot-com implosion launched the second-worst bear market since World War II. It wasn't Monopoly money: It was earmarked for retirement, for college tuition, for medical bills.

The Investor Class boomed in the 1990s as more and more people plunged into the market. At the start of the decade, they had \$712 billion in 401(k) and similar plans, 45% of it in stocks. By the end of 2000, that had ballooned to \$2.5 trillion, with 72% in equities. Their holdings of stock mutual funds mushroomed, too. Over the decade, the amount invested in them increased sixteenfold, to \$4 trillion. By the late '90s, the bull market had spawned the cult of equities. Not only did more people begin pouring cash into stocks, but their holdings increased exponentially as the indexes, especially the tech-laden Nasdaq, kept hitting new highs. CNBC and others covered the stock market like *Monday Night Football*. Investors of all stripes and sizes bought into the stock culture. Owning stocks—whether those of conservative Procter & Gamble or racier Yahoo!—was being in tune with the zeitgeist, simply a part of living in the '90s. "We were just riding the market, and we all felt like we were brilliant because our

IL 2001
of bad
news.
writes
\$2.5
ion in
entory

SEPTEMBER 2001

Market
closes for four
days after
September 11
terrorist
attacks. S&P
plunges on
Sept. 17 to
1038.77

DECEMBER 2001

Enron files for
bankruptcy
on Dec. 2.
S&P falls to
1129.90 the
next day

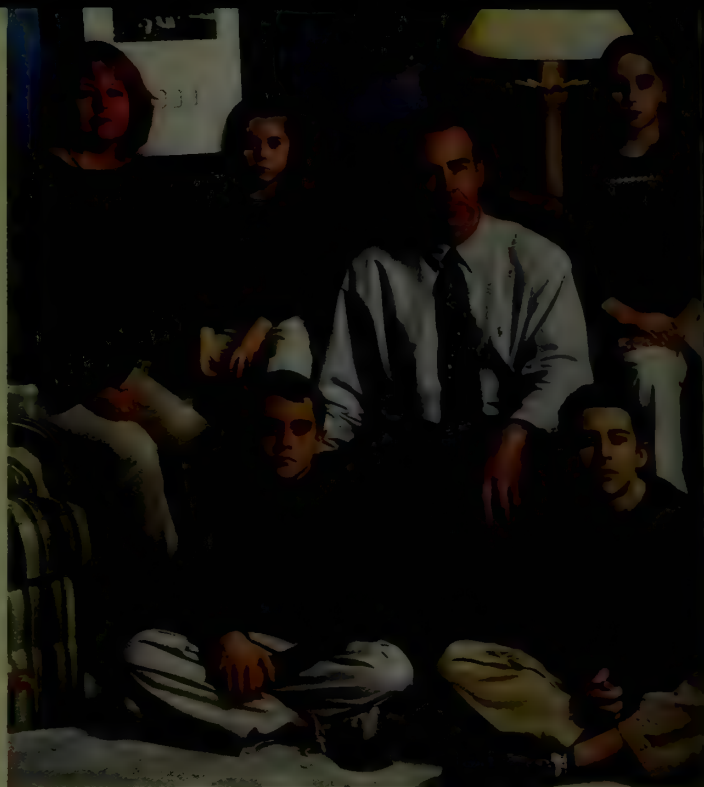
PHOTOGRAPH BY DOUG KANTER/AFP PHOTO/CORBIS; CHART BY RAY VELLA/BW

James J. Houlihan Jr.'s plan to retire at 50 is gone. In the last two years, he lost about 30% of a portfolio invested in such stocks as EMC, Lucent Technologies, and WorldCom. Now, the 41-year-old must also work harder to rebuild his four children's college funds. "I just don't understand how a business can appear to be so strong and in six months become a fraction of its value," laments Houlihan. "There are people who know what's going on, and then there's the rest of us." He'll save more and spend less—but he's not counting on stocks to make up for what's lost. He and his brother run an accounting firm in Fort Wayne, Ind., so it's not as if he doesn't understand analyst reports. But now, he says, "I don't pay them any credence. It's complete B.S. It's gotten to the point where you don't know who you can rely on."

“It's complete B.S....You don't know who you can rely on”

stocks were going up,” says James J. Houlihan Jr., an accountant from Fort Wayne, Ind.

The market's steep rise in the late '90s had a dramatic effect on business, too. Companies merged and acquired furiously. Investors clamored for initial public offerings. “Ventures were able to raise money much earlier in their life cycle, far before any anticipated profitability. In a different era, some of



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THE BETRAYED INVESTOR

Standard & Poor's. Millions of new jobs were created, and economic growth and productivity soared. It was boom time. Then it went bust.

Today, the Investor Class is angry and disillusioned because it feels betrayed. On the heels of Enron Corp.'s Dec. 2 bankruptcy filing—America's biggest ever—they are questioning the very integrity of the financial system. And they won't be ignored. They are a powerful group. Most—76 million, or a third of the adult population—are baby boomers who grew up in the era of protests and social activism. Then, they settled into comfortable middle-class prosperity. Once roused, they could again become a force of nature. And they vote.

Suddenly the deck seems stacked against them, at a time

when they expected to reap the fruits of their prime earning years. Instead, they're getting poorer by the day, while corporate insiders seem to make out like bandits: taking out millions in personal loans on cushy terms, rewarding themselves with rich options, bonus packages, and feather-bedded pensions. According to a Feb. 11 *BusinessWeek/Ipsos-Reid* poll, 81% of investors don't have much confidence in those running Big Business (page 108). And 68% have little or no faith that the stock market treats average investors fairly. The result: The new Investor Class is losing its appetite for risk and is parking its cash in unglamorous, low-yielding money-market funds and bank savings accounts. Far fewer are opening brokerage accounts. And last year, investors slapped a record 341 class actions on brokers—lawsuits that could cost the brokers as much as \$14 billion to settle—charging them with everything from issuing misleading prospectuses to taking kickbacks for IPO allocations. Individual complaints for bad advice soared as well.

How all this shakes out is vital to the health of the U.S. economy. If the crisis galvanizes companies and government into cleaning things up, investors will regain the confidence they need to put money to work in productive investments. The stock market will rebound, and companies will get the funding they need to grow. But if the malaise lingers, the bear market will drag on and the economy could suffer.

THE NEW INVESTOR CLASS

Portrait of a 100-million-strong power bloc

Data: The Pew Research Center for the People & the Press

HIGHLY EDUCATED

Most likely to have college, graduate, or professional degree.

MODERATE TO HIGH-INCOME

The vast majority earns more than \$50,000 a year; nearly half top \$75,000. A majority of those earning \$30,000 to \$50,000 also invest.

OVERWHELMINGLY WHITE

Caucasians are by far the most likely to invest. African Americans and Latinos are less than half as likely to invest as are non-Hispanic whites.

BOOMERS

The most likely investors are between the ages of 35 and 49. People under 25 are extremely unlikely to invest, while only about 40% of seniors are in the market.

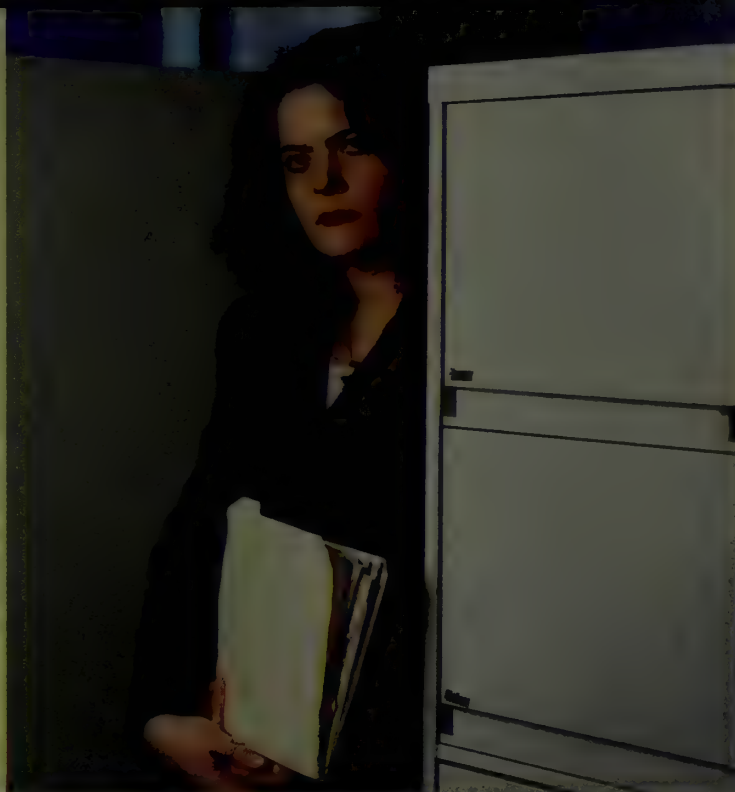
SUBURBAN HOMEOWNERS

Some 60% of suburban investors, while under half of inner-city and rural investors, are more likely to invest than rural investors.

THE ATTORNEY WHO STOPPED OPENING HER STATEMENTS

Until three years ago, 31-year-old Manhattan attorney Heather E. Barr had no interest in the stock market or planning for retirement. She finally signed up for one of three Salomon Smith Barney Inc. funds offered by her company's 401(k) plan at the urging of a co-worker. It also happened to be at the peak of the market. For a while, the account did fairly well, but by last year, she had lost a third of her money. The last time she looked, the account was worth less than \$2,000. She has since stopped opening her statements. While she still puts an automatic \$50 a month into the plan, she's not holding out hope for a rebound: "I don't have faith in the stock market," she says. "Everyone says you have to ride it out and be in for the long haul. Maybe that's true, but putting money in a shoe box would have landed me more."

"Putting money in a shoe box would have landed me more"



tal for entrepreneurial ventures and research and development dries up. For sure, the fear that many big companies are cooking their books makes for a much riskier market. The experts paint fairly extreme scenarios: "It could lead to a rise in the cost of capital [and] lead to serious concerns about foreigners wanting to invest in America," Senator Jon Corzine (D-N.J.), a former Goldman, Sachs & Co. co-chairman, recently told the Senate Budget Committee. With investor angst rising, Washington has swung into action. Never before have the politicians faced the wrath of so many disaffected investors. In a highly partisan atmosphere, Republicans and Democrats are both moving to shape post-Enron, confidence-building reforms. Even conservatives who tout the virtues of deregulation, individual choice, and private accounts for Social Security and medical care know they cannot promise the magic of democratized investing, while the depression grows that the game is rigged against the little guy. No fewer than 12 congressional committees are probing the Enron scandal and rushing to hammer out reforms designed to do everything from reining in Wall Street analysts to imposing tougher accounting rules on companies and bringing up safeguards on America's retirement savings. Rarely has Capitol Hill reacted so fast to a burgeoning market crisis. But it will take more than dozens of rapidly drafted proposals and public posturing to restore confidence.

Suddenly, no one knows who to trust. In the *BusinessWeek*/Ipsos-Reid poll, 54% of investors said they are concerned about the honesty and reliability of the investment information they receive. "It's a strange time. People wonder if the wool is constantly being pulled over their eyes. It makes for a very vulnerable market," says Robert J. Shiller, economics professor at Yale University and the author of the 2000 best-seller *Irrational Exuberance*.

Indeed, the Enron scandal and the swift bankruptcy of upstart telecom Global Crossing Ltd. have cast a long shadow of suspicion about possible accounting improprieties at company after company. The stock prices of energy outfit Calpine, conglomerate Tyco International, and megabank J.P. Morgan Chase have been battered because of questions about accounting practices (page 110). Even such blue chips as General Electric Co. and IBM are under the microscope. Americans who came to see their free-market economy as largely immune to the cronyism that plagues many foreign countries were shocked to see how Enron's cozy ties with its own accounting firm inoculated it from scrutiny. "Enron has been elevated to a symbol," says Woody Dorsey of Market Semiotics, an institutional forecasting service. "There's a whole new level of uncertainty about profits, about the integrity of the accounting profession and of Wall Street."

The usual investor watchdogs—the board, auditors, and

CARRIED

People get what they think is a sure thing. They are much more likely to invest in stocks, especially if they are young.

BICOASTAL

People on the East and West Coasts are most likely to invest. Southerners are the least likely.

HIGHLY INFORMED

Investors tend to read a daily paper, regularly watch the evening news, subscribe to magazines, and use the Internet.

POLITICALLY ACTIVE

Investors tend to be party loyalists: Republicans and Democrats are more likely to invest than Independents. No ideology prevails. Active traders are strongly Republican.

WHITE-COLLAR/BLUE-COLLAR

Union members are more likely than nonunion members to invest. The most prominent investors, however, are professionals and business execs.

NO GENDER GAP

Virtually the same number of men and women are investors. Active traders are mainly men. Women form a majority of stock, bond, mutual-fund, and 401(k) holders.

For Laurence Kramer, 56, and his wife, Ellen, 49, the best investment these days is a savings account earning 2%. The Kramers, once aggressive investors who devoted 10% of their annual income to buying stocks, got fed up with their brokers and stopped putting money into the market last March. "They all dropped the ball," says Ellen, who owns a designer-clothing boutique in Armonk, N.Y., where the couple lives. "It's 'Oops, I just lost \$500,000'—and then they don't return your phone calls." That's not all: Accounting fraud, they fear, will plague more U.S. companies. "The depth of the deceit is extraordinary," says Laurence, a lawyer. "It has made us gun-shy and has undermined the faith that we had in major corporations."

“The depth of the deceit is extraordinary”



regulators—all seem to have been asleep or deeply conflicted about their roles. Even professional investors are consumed with fox-minding-the-henhouse worries. In a Feb. 5 study by *Wall Street Reporter* magazine, 43% of 322 professionals polled said that they are “extremely concerned” about the potential for widespread financial-reporting

system is broken. We have the lowest capital costs of place in the world, because we’ve demonstrated that investors’ money is safer here.” These Establishment figures argue that the economy seems to be picking up steam. In spite of the flaws, they say, the U.S. still has the most rigorous reliable accounting system, and most companies follow the rules. “The market has already responded to the potential overstated profits in the same way it responds to an unexpected negative event: ready, fire, aim,” says Jeffrey M. Plegate, chief investment strategist at Lehman Brothers.

Even so, some analysts believe the market as a whole remains overvalued. The market’s price-earnings ratio is high by historical standards—despite today’s low inflation and inter-

Cover Story

THE BETRAYED INVESTOR

fraud, and 61% said regulators could do a better job.

Of course, the heavy hitters in Washington, on Wall Street, and in corporate boardrooms contend that investors are overreacting. Says Treasury Secretary Paul H. O’Neill: “While we may need to do some repair work, I don’t believe that our

THEY’RE FED UP

How badly has the Enron fiasco shaken confidence in the markets? An Ipsos-Reid poll of 619 investors* conducted for *BusinessWeek* on Feb. 11 found that they don’t see Enron as an isolated case. They are not pulling out of stocks en masse, but they want business to clean up its act and regulators to beef up policing. Highlights of the poll:

THE ENRON EFFECT

Which of the following comes closest to your opinion about the Enron case?

It’s a totally unique situation that applies only to Enron...10%
It’s an indication that some well-known corporations have begun using questionable accounting practices of the kind that got Enron into trouble...60%
It’s proof that there may be an epidemic of deceptive accounting practices involving many well-known corporations...28%
Not sure...1%

Looking ahead, how will the Enron case affect your actions as an investor in the next six months?

It will not seriously affect my investment decisions...43%
It will make me much more cautious before I make an investment in a particular company...41%
It will make me reluctant to invest any more in stocks until I get a better understanding of the extent of the problem...14%
Not sure...1%

GIVE THEM MY MONEY?

Over the next six months, do you think you will probably invest in stocks or stock mutual funds?

	2/11/02	11/30-12/3/01**	11/28-12/4/00**	12/2-12/7/00**
A lot more	4%	4%	7%	10%
Somewhat more	25%	24%	35%	37%
Reduce somewhat	13%	15%	13%	10%
Reduce a lot	8%	9%	5%	5%
Stay the same	47%	42%	32%	29%
Not sure	4%	6%	7%	10%
Total Invest More	29%	28%	42%	47%
Total Reduce	21%	24%	18%	15%

KEIN THEM IN

Do you favor or oppose the following proposals?

	STRONGLY FAVOR	SOMEWHAT FAVOR	STRONGLY OPPOSE	SOMEWHAT OPPOSE	NOT SURE
Making top corporate officials who are found guilty of serious financial fraud liable for criminal prosecution	89%	10%	1%	1%	—
Requiring executives to release to employees and investors more timely and accurate information about a company’s financial health	87%	9%	2%	1%	2%
Beefing up the Securities & Exchange Commission auditing and enforcement division to increase federal policing of the accounting industry	47%	29%	12%	9%	2%

*Out of 768 adults interviewed, 619 were investors; margin of error for investors: +/- 4%

**BW Harris Poll

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* A full service offering may not be available in some areas

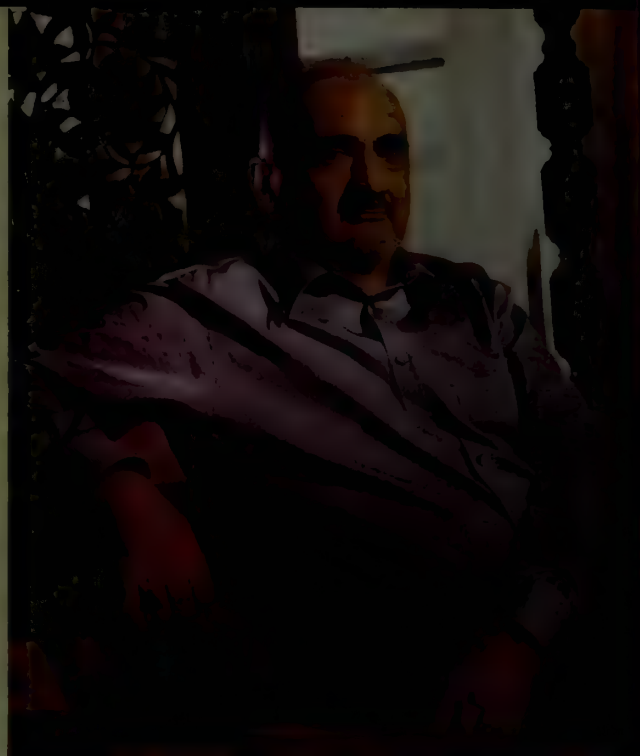
Blair R. Williams, 63, has always distrusted Wall Street, but now he's deeply cynical. "Do they deliberately lie? The average investor may never know," he says. "But there are lots of people trying to lead us down the garden path." Williams, who lives in a retirement community in Monroe, N.J., entrusted \$70,000 to a UBS PaineWebber broker last year. After three months, only \$20,000 remained. "He seemed to

Cover Story

THE BETRAYED INVESTOR

have a great ability to pick absolutely the wrong stock." A week after his broker bought Compaq Computer Corp. at \$45, the stock halved. Williams and his wife—who lost 15% of a \$2 million nest egg in two years—now manage more of their own investments. "I'm much more distrustful of everything because of the markets, the dot-coms, and the Enrons," he says. "It was all fueled by greed."

**"I'm much more distrustful...
It was all fueled by greed"**



rates. The S&P 500 stocks now trade, on average, around 21 times estimated 2002 earnings—down from around 25 near the March, 2000, peak but still way above the historical average of about 15.

Worse yet, the e's in the p-e ratios could be substantially overstated. The worry is that thousands of companies have consistently, and legally, overstated earnings for the past few years. Robert Barbera, chief economist at Hoenig &

Co., figures most of the 26% operating earnings growth reported by S&P 500 companies from 1997 through 2000 was result of accounting shenanigans. "I don't believe that earnings growth in the late 1990s was there," he says. "It's because tactics such as inflating earnings by excluding the cost of employee stock options from expenses and relying on massive restructuring charges came into vogue. Even established companies started using accounting voodoo,

turning the rising value of their pension-plan assets into higher earnings and using so-called pro forma numbers.

But post-Enron, the accounting games are coming to a shuddering halt. For years to come, investors may question the figures they accepted in the past. Financial reporting is sure to become more conservative. So even when the market settles down, reported earnings are unlikely to boom again and rekindle the force of the last bull market. "It is not that we can't go back to where we were. We were never there to begin with," adds Barbera.

That's especially worrisome because when a crisis like Enron occurs during a bear market, stocks typically take about 12 months to recover, according to a study by Crandall, Pichler & Co., a Libertyville (Ill.) investment research firm. And recovery times from earlier stock market bubbles are sobering. It wasn't until 1958 that the market regained its inflation-adjusted 1929 pre-crash level, according to Yale's Shiller. Two decades after 1929, the average real return for the stock market, including dividends, was 0.4% a year, vs. the 25% investors began to use in the late 1990s. Most economists doubt that history will repeat itself so cruelly. At all, the U.S. economy is in much better shape now, and the stock market—though it may be a riskier place than many new investors imagined—has a more level playing field than it did in the post-Depression era.

Still, that's cold comfort for ordinary

THE FALLOUT

Since Enron's bankruptcy filing on Dec. 2, the market has punished companies with any hint of murky accounting.

COMPANY	STOCK FALL SINCE NOV. 30*	ACCOUNTING ISSUE
CALPINE	60.3%	Discloses a confusing contract with Enron on debits and credits
MIRANT	57.6	Moody's downgrades debt, warns of off-balance-sheet risks
TYCO	48.2	Spars with short-sellers over earnings-growth figures
AES	38.6	Announces earnings with a long list of adjustments
WILLIAMS COS.	38.4	Delays full financial report to re-tally off-balance-sheet liability
RELIANT	31.2	Delays 2001 results to restate earnings
QWEST	22.6	Telecom bankruptcies cast new doubt on accounting
CISCO	15.6	Haunted by \$2.5 billion inventory writedown in 2001; new concerns over revenue padding
J.P. MORGAN CHASE	15.6	Reveals new risks from Enron off-balance-sheet vehicles
COMPUTER ASSOCIATES	14.6	Changes revenue accounting; Moody's questions outlook

*Through Feb. 12

Data: Bloomberg Financial Markets, *BusinessWeek*



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vestors, who read daily about corporate chieftains profiting from insider sales while their own portfolios shrivel. Says Charles Prestwood, a 63-year-old retired Enron employee who lost practically all of his \$1.3 million savings, invested in the company's stock: "Something stinks here...there are people at Enron who made millions selling the stock while we, the rank and file, got burned." Such practices weren't confined to Enron. According to SEC filings, Global Crossing Chairman Gary Winnick sold \$734 million in shares before the profitless company collapsed.

Arrogant execs are not the only targets of investors' ire. Morgan Stanley Dean Witter analyst Mary Meeker, the one-time "Queen of the Net," pulled down a \$15 million pay package in 1999—the eve of the dot-bomb. There's no telling how much money analysts such as Meeker cost investors with their interminable buy recommendations on Internet stocks that eventually went bust.

Indeed, many Wall Street analysts seem to need their own analysts these days—those of the Freudian persuasion. Eleven out of 16 analysts who follow Enron had buys or strong buys on it as late as Nov. 8, despite a series of red flags ranging from a \$1.2 billion reduction in shareholder equity to an SEC probe. Part of the problem is that few truly analyze companies these days. Says Paul Patterson, a utility analyst at ABN Amro Inc. in New York: "Analysts don't want to be on the wrong side of a stock that's going up."

What's worse, since they often get paid according to how much investment banking business they can drum up for their firms, analysts play a dual role that is often deadly for investors. At the height of the bull market, Salomon Smith Barney telecom analyst Jack Grubman had buy recommendations on practically all the companies he covered. During that time, Salomon was loading up on investment banking fees from telecom companies, racking up almost \$1 billion since 1997—more than any other Wall Street firm. Now, nine of the companies Grubman cheered during the telecom craze are trading for less than \$1 a share. At least four are in bankruptcy.

No surprise, then, that shareholders are clamoring for more accountability. Most want to see some of the high-profile execs and accountants who've misled them join the ranks of

the chain gang. In our poll, 89% of investors say they strongly favor the criminal prosecution of corporate officials who implicated in serious financial fraud.

In an effort to placate an angry public, the New York Stock Exchange and the National Association of Securities Dealers issued a proposal to the Securities & Exchange Commission on Feb. 7 that would limit compensation that analysts can receive from investment-banking activity. Other rules would restrict analysts' trading of stocks they cover, prohibit them from reporting to their firm's investment bankers, and prohibit them from promising favorable ratings to companies they cover.

Enron's collapse has also rocked the agenda of Washington conservatives. For a decade, GOP strategists predicted that the steady rise of the Investor Class would create a powerful political force in their favor as shareholders saw that wealth came from capital gains, not wages. The result would be an

inexorable tilt toward GOP-shrined policies, such as across-the-board cuts in marginal rates, deregulation, and budgetary restraint. Ultimately, proselytizers insisted, the embrace of the small-investor ethic would create a receptive climate for conservative choice agenda. Empowered by the success of their self-directed 401(k) plans, they hoped stock owners would vote for policies that put individual not government, in charge of retirement and health care.

Many voters still support choice, but the crown jewel of the agenda—replacing part of Social Security with individual accounts invested in stocks and bonds—stalled when federal budget surpluses ended. Officials like Lawrence B. Lindsey, President Bush's chief economic adviser, think that the bear market hasn't shaken the agenda. "The theme of all the President's policies is to give people more control over their lives—be it their money, retirement savings, Medicare decisions," Lindsey says. "There's a recognition that we're in this for the long term."

Even so, investors' response to Enron—and the fear of more Enrons—has taught conservatives a sobering lesson. The clamor for accountability in the financial system means more rules and regulations in the sector they have spent decades trying to deregulate.

With "we told you so" Democrats also in full cry, there's a predictable result: a regulatory stampede not seen since the savings and loan crisis of the 1980s. Democrats will be first out of the blocks, calling

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THE BETRAYED INVESTOR

POST-ENRON REFORMS: WHAT'S REAL AND WHAT'S NOT

The prospects for congressional action.

PENSION SECURITY

- Employees can sell stock from company matching programs sooner. *Count on it.*
- Employers can hire outside advisers to guide workers on investing their 401(k) cash. *A lock.*
- Employees get to elect trustees for 401(k)s and pension plans. *Unlikely to pass.*

CORPORATE ACCOUNTABILITY

- Faster reporting of all insider stock trades. *Excellent. Could happen in 2003.*
- Suing corporate officers for financial chicanery becomes easier. *Dubious. Conservatives oppose.*
- Companies must book stock options as an expense. *Good. Has bipartisan backing.*

FINANCIAL DISCLOSURE & TRANSPARENCY

- Closer SEC scrutiny of financial reports. *Certain. Commissioners have gotten the message.*
- Investors get more company data and faster. *Likely. Treasury Dept. will embrace the idea, but the scope of the rules remains vague.*
- Crackdown on corporate tax shelters. *Dicey. The worst may go, but new mutants will emerge.*

ACCOUNTING

- New private-sector board to probe accounting failures and discipline auditors. *Certain.*
- Accountants can't consult for audit clients. *Good. Big Five are already splitting the roles.*
- Accounting rulemaker FASB overhauled to cut industry and political clout. *Iffy. Republicans prefer market-based reforms.*

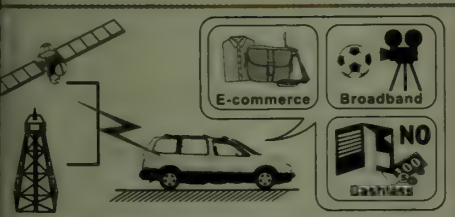
POLITICAL REFORM

- Banning soft-money donations to political parties. *Some measure likely. But corporate cash will find new roads to politicians' pockets.*

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Changes for the Better

for limits on the amount of company stock in 401(k) plans and moves to ease shareholder suits against corporate officers, directors, and auditors. But GOP lawmakers are starting to fill the House and Senate hopper with proposals. On Feb. 13, the Republican leadership of the House Financial Services Committee introduced a

sweeping set of reforms. They include the creation of a Public Regulatory Organi-

zation to investigate auditing failures and discipline errant CPAs, a ban on accountants consulting for audit clients, and increased funding for the SEC's enforcement and corporation-finance divisions.

Despite bipartisan tears for Enron's victims, the parties are taking different approaches. Democrats see Enron as justification for a strong assertion of government power to outlaw conflicts of interest and even restore the ban on companies operating in both the banking and securities industries. "We can-

not legislate against greed, but we can and should do what is possible to prevent greed from prevailing," says Senate Judiciary Committee Chairman Patrick Leahy (D-Vt.).

But in the GOP, proponents of investor empowerment are more likely to prevail. Treasury Secretary O'Neill—charged by President Bush with proposing reforms in corporate governance—and SEC Chairman Harvey L. Pitt don't think Washington rulemakers can anticipate "all the combinations and permutations of every business activity in the world," O'Neill puts it. Instead, they would cater to the Investor Class with more transparency.

On Feb. 13, the SEC took a large step in that direction announcing plans to impose far stiffer disclosure rules on companies. Companies must produce quarterly reports within 30 days, rather than 45, and their annual reports in 90 days, rather than 90. Significant trading in company stock by officers and directors must be revealed immediately. All important changes in business must be reported within 48 hours, including waivers from corporate ethics rules or off-balance-

Cover Story

THE BETRAYED INVESTOR



COMMENTARY

By Michael J. Mandel

A NEW ECONOMY NEEDS A NEW MORALITY

Each economic era has its characteristic moral struggle. For most of the past 50 years, the moral and political debate in capitalist economies focused on the tug-of-war between income equity and economic efficiency. Liberals argued that it was a moral duty for society to extend a helping hand to those less fortunate—the poor, the unemployed, the less-skilled, the elderly. Conservatives, by contrast, held that boosting productivity, efficiency, and output was commendable and socially virtuous. Together, these two imperatives formed the moral foundations of the post-World War II American capitalist economy.

Equity and efficiency are still impor-

tant today. But the fall of Enron Corp. does not fit neatly into the efficiency-equity debate—and neither do the other big economic and financial disasters of recent years, such as the accounting scandals, the dot-com crash, and the telecom meltdown. Despite all efforts of Democrats to put a populist spin on these crises, they have not resulted in massive spasms of unemployment that hurt the poor and widened income distribution. Instead, it has been the Investor Class that has absorbed much of the pain. Nor, to the chagrin of Republicans, can the problems be attributed to government overregulation that hurt efficiency. Rather, they were arguably the result of a lack of oversight.

The moral outrage today focuses on risk. Basically, investors and workers are incensed at being snookered by companies taking risks they didn't understand. They wouldn't have willingly accepted the risks they faced. Venture capitalists brought high-risk startups public without clearly informing investors of the dangers. And more broadly, greedy executives and financiers have been taking on risk to other people without informed consent, undermining the security.

This is still an equity and fairness issue, but it's a much different sort of issue than in the past. Compared with the Old Economy, the New Economy is

financing. Write-offs large enough to affect a company's earnings must also be reported quickly. And the SEC wants to bar serious corporate wrongdoers from serving in key positions again. "We believe that we should not give officers and directors who betray their trust a second bite of the apple," says Pitt.

Neill wants to hold both corporate CEOs and auditors responsible for ensuring that investors are fully informed. He would have to sign off on a checklist of corporate risk indicators—the 5 to 10 key factors affecting a company's future. Top company officials would be personally responsible if the list were incomplete or misleading. Similarly, the treasury chief is likely to propose that auditors give their companies performance ratings for the quality and completeness of their financial controls. That would replace the boilerplate audit opinions—a test that few companies can flunk.

Washington, is of course, responding to an angry Investor. That's not half bad. But investors shouldn't let down

their guard too soon. After all, what got us to this sorry state was a willing suspension of disbelief about the laws of the market. Real resources went to waste on dimwit dot-coms and overstocked telecom gear. The irrational exuberance of the '90s was as harmful as the irrational pessimism that could grow out of investors' feelings of betrayal. The best outcome from the present wave of angst would no doubt be a return to commonsense investing. Investors should place their bets on rationality, not the next skyrocketing stock.

By Marcia Vickers in New York and Mike McNamee in Washington, with Peter Coy, David Henry, Emily Thornton, and Mara Der Hovanesian in New York, and bureau reports

BusinessWeek online

For interviews with SEC Chairman Pitt, Treasury Secretary O'Neill, and more poll results, go to the Feb. 25 issue online at www.businessweek.com.

on risk-taking. Financial markets are much more central, venture capital and startups more important, and options more pervasive. Technological and market innovation is essential.

There's a moral vacuum at the heart of the New Economy that needs to be filled. A clear consensus hasn't emerged about the dividing lines between acceptable and unacceptable risk. We want to be able to take risks—the next hot stock, join the company. But they want to be able to decide, knowledgeably, how much risk to take.

Here are some principles that are a part of a moral framework for the New Economy:

Risk-taking in the pursuit of innovation and growth is both desirable and commendable.

Entrepreneurs, aggressive investors, and risk-taking workers are to be celebrated for their contributions to the economy. Business journalists were right to draw attention to people like Jeff Bezos, the founder of Amazon.com, because he exemplifies a willingness to take the sort of risks that drive the U.S. economy forward, creating future generations and the global world.

Encouraging risk-taking is only half the equation. The other half is to ensure that it is under control—and that's where the real mistakes were made.

Transparency is an essential virtue.

Rules of accounting have always been required, at least theoretically, to ensure disclosure. But in the New Economy, transparency becomes a moral imperative. Innovation is not enough without the true risks being disclosed and hidden. Thus,

Enron's shareholders were cheated because they did not receive full information about the true debt and profits of the company. And while most venture capitalists did nothing illegal when they made big bucks by selling risky dot-com and telecom startup shares to small investors, they did commit a moral wrong.

Imposing risk on others without their informed consent is morally problematic.

In business and technology, uncertainty is unavoidable. But pushing risk on to others without their consent is a bit like dumping garbage on other people's property in the middle of the night. Forcing employees to hold excessive amounts of company stock in their

portfolio absorbing the risk worse off.

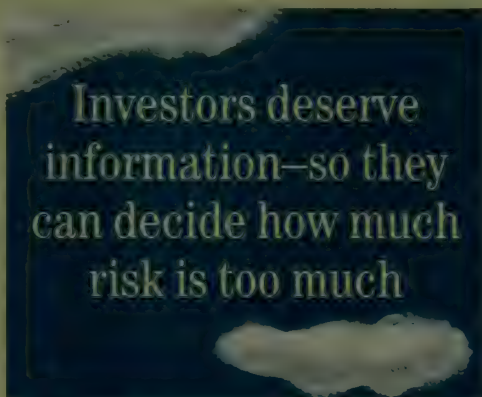
Richer people, organizations, and countries should be encouraged to take on a larger share of the risk.

The concept of charity, in the sense of giving of money, is a familiar one. But it's an equally important moral imperative for the riskiest projects and activities to be taken on by those best able to bear the uncertainty, while poorer people should have more income and job security. Wealthy corporations have a responsibility to fund risky innovations even if it doesn't immediately help the bottom line. Rich countries such as the U.S. are morally bound to make investments in the developing world even if the risks are high.

It should be noted that encouraging the rich to take more risks could well widen the income gap, because, typically, higher-risk investments have bigger payoffs. For example, the U.S., with big investments in startups and cutting-edge technologies, took more risks than other countries in the 1990s and was rewarded with faster growth. That widened the gap between the U.S. and other countries.

Moral principles do not immediately translate into policy. The appropriate balance between equity and efficiency has been the focus of political debate for decades. Similarly, the fight over how to regulate risk and security is only now starting, as Congress considers reforming pension plans, 401(k)s, Social Security, and disclosure requirements. But no matter what laws are eventually passed, moral foundations are critical to reassure jittery investors and workers, and to put the New Economy on a firm footing.

Mandel is chief economist.



401(k) accounts, for example, imposes unnecessary risks on people. Similarly, a company that offers only health-care plans with high deductibles to workers as a way of lessening its own financial risk may be stepping over the line.

This sort of risk-shifting, in which workers, shareholders, and consumers are forced involuntarily to bear undue risk, is not acceptable. Imposing non-consensual risk is in some ways like stealing: On average, it makes the peo-

By Gary Weiss

CONGRESS WILL HUFF AND PUFF AND...DO LITTLE

A headline-grabbing scandal. Congressional hearings. Criminal charges on the horizon. It's happening now with Enron Corp., but every few years, it seems, a new scandal hits Corporate America—be it junk bonds or the demise of Long-Term Capital Management. And in almost every case, after the smoke clears, nothing of substance changes as lawmakers and regulators back away from meaningful reform. Will Enron be different?

The conventional wisdom is that it will, because the scandal is unprecedented in scope. Even the most jaded observers find the fallout staggering. "It's a really powerful issue for people. I'm pretty comfortable that this is going to be an exception from the past, that there will be real change," says Michael F. Bachner, a New York securities lawyer who has represented aggrieved investors and criminal defendants alike.

But it's premature to assume that Enron will be an exception to the rule of sound and fury followed by nothing. Public memories are short. Despite the groundswell in sentiment for regulation, the new Investor Class remains amorphous and disorganized. And televised appearances to the contrary, lawmakers are certainly going to listen when the Wall Street and



The S&L crisis was an accounting crisis, too—and the accountants got off scot-free

HUE AND CRY: KEATING TESTIFYING IN THE '80S

Management in 1998. Attention focused on LTCM's leverage and use of derivatives and on the secretive world of hedge funds. Study commissions were appointed, legislation proposed. But four years later, what was the result? Nothing. Likewise, the penny-stock scams of the 1980s resulted in regulations, such as sales-practice rules, that were easily circumvented in the 1990s by a new generation of stock scamsters.

True, the savings-and-loan scandals produced prosecutions and a regulatory overhaul. But the S&L crisis was as much an accounting debacle as Enron is—and the accountants got off scot-free. Accountants allowed thrifts to keep junk bonds on the books at cost, rather than marking them to market when they lost value. Shrugging off their profession's dismal performance, accountants successfully dodged reforms—despite a hue and cry that included televised congressional testimony by former

S&L exec Charles Keating. At the end of the day, "the S&L scandal did not result in any reforms—it resulted in just the opposite, a so-called reform act that made accountability less important," notes Melvyn I. Weiss, a prominent securities lawyer representing plaintiffs.

Indeed, Congress must share the blame for Enron because it chipped away at investor protections. The Private Securities Litigation Reform Act of 1995 "set the stage for all that went wrong at Enron. They removed the 'aider and abettor' rules, so the accountant and lawyers and consultants could give advice without any liability," says John Lawrence Allen, a New York securities lawyer.

True, Congress was ostensibly aiming at curbing frivolous lawsuits. But plaintiffs' lawyers have a point, in the wake of Enron, when they maintain that Congress went too far. Lawmakers now are weighing a host of proposals and some of them are likely

to be enacted (table, page 112). The days of accountants consulting for auditing clients are no doubt gone. Pension rules will probably be strengthened. Criminal prosecutions are likely and would help deter further wrongdoing.

But Congress needs to show some leadership and tackle issues the securities and accounting industries will find distasteful. Auditors must have an affirmative duty to look for fraud. Analyst independence—and freedom from investment-banker influence—must be guaranteed. And the SEC, working with federal prosecutors, should act forcefully against corporate officers who tell lies.

Taking such steps is going to require substantial political will. It will mean facing down powerful lobbyists Grandstanding before the TV cameras is so much easier.

Senior Writer Weiss has covered Wall Street scandals since 1986.

Cover Story

THE BETRAYED INVESTOR

accounting lobbies speak—and fill their campaign coffers. Former Securities & Exchange Commission Chairman Arthur Levitt Jr. recently told reporters that few lawmakers are friends of investors. "The political class is anti-regulatory," Levitt said, adding that he expects "blocking legislation to stem Draconian steps."

History abounds with examples that support Levitt's thesis. Consider the collapse of Long-Term Capital



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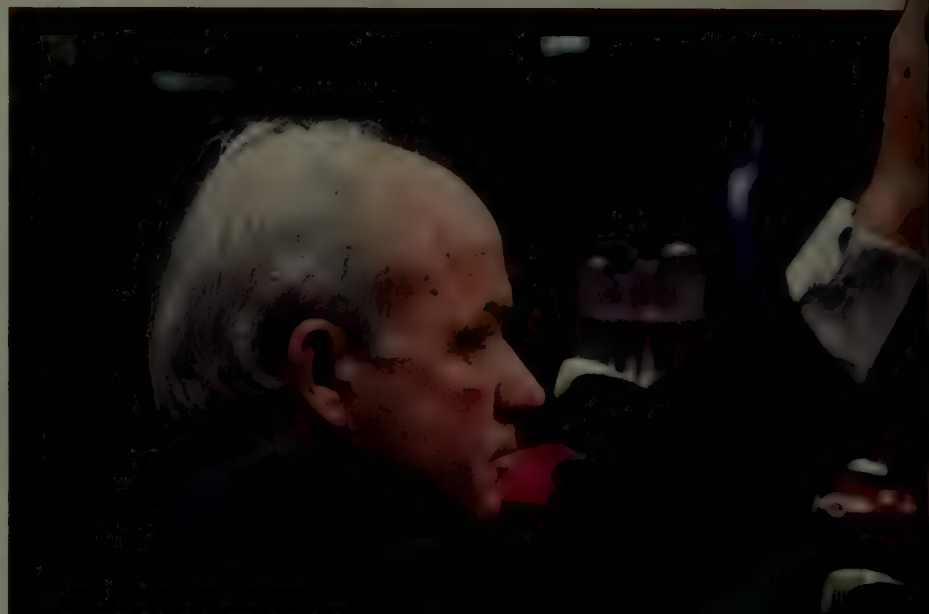
Enron's unrelenting stress on growth and its absence of controls helped push execs into unethical behavior

At Enron Corp., they called her "the Weather Babe." Lynda R. Clemmons, a French and history major from Southern Methodist University, was supposed to be emblematic of the rebels in Enron's free-wheeling culture. In 1997, as a 27-year-old gas-and-power trader, she launched an esoteric enterprise in weather derivatives. Within two years, her startup had written \$1 billion in weather hedges to protect companies against short-term spikes in the price of power during heat waves and cold snaps.

Clemmons' story made the rounds, from a favorable Harvard Business School case study to *The New York Times* business section, where she was pictured in black leather on a Harley-Davidson. She was, after all, a product of what Enron's culture was supposed to be all about: smart, sassy, creative, and risk-taking. And Enron made the most of her business, trumpeting weather derivatives as yet another high-potential deregulated market.

Like other Enron initiatives, this one never lived up to the hype. "It was such a flaky business," says John Olson, an analyst at Sanders Harris Morris in Houston. "They got more mileage out of the public relations than they actually made in earnings." Not exactly the way Enron's "cultural revolution" was supposed to play out. But as everyone knows, with Enron, nothing was quite as it appeared.

For most of the 1990s, CEOs at Old Economy companies struggled to turn slow-moving organizations into nimbler, more flexible outfits. Failure cost chieftains their jobs at General Motors, Eastman Kodak, Westinghouse, and a host of other behemoths. Truth is, real transformations are the exception rather than the rule. Changing the core values, the attitudes, the fundamental relation-



CORPORATE CULTURE

'THE ENVIRONMENT WAS RIPE FOR ABUS

ships of a vast organization is overwhelmingly difficult. General Electric Co.'s John F. Welch and IBM's Louis V. Gerstner Jr. have been lionized for having led two of the very few successful makeovers.

That's why an army of academics and consultants descended on Enron in the late 1990s and held it up as a paragon of management virtue. Enron seemed to have transformed itself from a stodgy regulated utility to a fast-moving enterprise where performance was paramount. The Harvard case study put it simply enough: "Enron's transformation: From gas pipelines to New Economy powerhouse."

If only that were true. Many of the same academics are now scurrying to distill the cultural and leadership les-

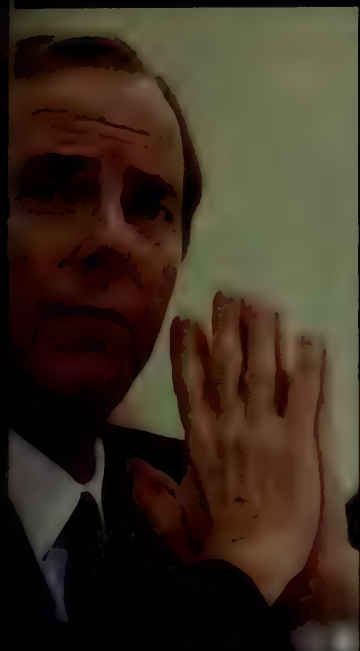
sons from the debacle. Their conclusions so far: Enron didn't fail just because improper accounting or alleged corruption at the top. It also failed because of its entrepreneurial culture—the very reason Enron attracted so much attention and acclaim. The unrelenting emphasis on earnings growth and individual initiative, coupled with a shocking absence of the usual corporate checks and balances, tipped the culture from one that rewarded aggressive strategy to one that increasingly relied on ethical corner-cutting. In the end, much leeway was given to young, experienced managers without the necessary controls to minimize failures. Enron was a company that simply placed a lot of bad bets on businesses that were so promising to begin with.

Before 1990, Enron was a sleepy, regulated natural-gas company dominated by engineers and hard assets. But the

ENRON & BEYOND

How A New Economy Corporate Culture Went Awry

TYPE OF CULTURE	EMPLOYEE EXPECTATIONS	REWARDS	LEADERSHIP
OLD ECONOMY	Security	Salary	Top-down
NEW ECONOMY	Personal growth	Stock options	Inspirational
THE ENRON TWIST	Personal wealth	A stake in the business	Know-it-all arrogance



SKILLING Many CEO was encouraging risk-taking at Enron



ANDREW FASTOW Did he exploit performance reviews to get back at those who opposed him?

KENNETH LAY The chairman hired Skilling in 1990 with a goal to build Enron Finance Corp. into an asset-light company for financially linked products and services

Enron Chairman Kenneth L. Lay hired McKinsey & Co. partner Jeffrey Skilling, who had been advising Lay as a consultant. Skilling's mandate was to build Enron Finance Corp. into an asset-light laboratory for financially linked products and services. Skilling expanded the unit into a model of what all of Enron would become. Its success led to Skilling's promotion to president in 1997 and CEO in early 2001. Skilling's recipe for changing the company was right out of the New Economy playbook. Layers of management were wiped out. Hundreds of outsiders were recruited and encouraged to bring new thinking to a tradition-bound business. The company abolished seniority-based salaries in favor of more highly leveraged compensation that offered big cash bonuses and stock options to top performers. Young people were just out of undergraduate or

MBA programs, were handed extraordinary authority, able to make \$5 million decisions without higher approval. In the new culture, success or failure came remarkably fast. "One potential flaw in the model was that Enron managers tended to move relatively quickly, not within businesses but between businesses," says Jay Conger, a management professor at London Business School who studied Enron. "If you move young people fast in senior-level positions without industry experience and then allow them to make large trading decisions, that is a risky strategy." It was not unusual for execs to change jobs two or three times in as many years. Indeed, turnover from promotions alone was almost 20%. Clemmons, for example, went from analyst, to associate, to manager, then director, and finally to vice-president running her own business, all in seven years.

"In larger companies like IBM and GE, even though there is a movement toward youth, there are still enough older people around to mentor them," says James O'Toole, professor at the Center for Effective Organizations at the University of Southern California. "At Enron, you had a bunch of kids running loose without adult supervision." In theory, of course, the kids were closely supervised. Skilling often described the new culture as "loose and tight," one of the eight attributes of the successful companies profiled by McKinsey consultants Thomas J. Peters and Robert H. Waterman Jr. in their best-selling book, *In Search of Excellence*. The idea is to combine tight controls with maximum individual authority to allow entrepreneurship to flourish without the culture edging into chaos. At Enron, however, the pressure to make the numbers often overwhelmed the pretext of "tight" controls. "The environment was ripe for abuse," says a former manager in Enron's energy services unit. "Nobody at corporate was asking the right questions. It was completely hands-off management. A situation like that requires tight controls. Instead, it was a runaway train." The train was supposed to be kept on the tracks partly by an internal risk-management group with a staff of 180 employees to screen proposals and review deals. Many of the unit's employees were MBAs with little perspective and every reason to sign off on deals: Their own performance reviews were partially done by the people whose deals they were approving. The process made honest evaluations virtually impossible. "If your boss was [fudging], and you have never worked anywhere else, you just assume that everybody fudges earnings," says one young Enron control person. "Once you get there and you realized how it was, do you stand up and lose your job? It was scary. It was easy to get into 'Well, everybody else is doing it, so maybe it isn't so bad.'" It didn't help that Enron's Risk Assessment & Control group was answerable not to the board of directors but to Skilling, who was encouraging all the risk-taking. Another essential "check and balance" in the culture—Enron's

ORGANIZATION	CORPORATE GOAL	BOARD	APPROACH TO REGS
Enron	Steady growth	Rubber stamp	Aim to meet regulations
McKinsey	Fast growth	Independent	Push the limits
Financial fiefdoms	Appearing to grow fast	Rubber stamp	Circumvent the rules

Enron bred a yes-man culture: People were afraid to get crossways with someone who could screw up their review

in-house legal staff—was also compromised because of its reporting relationships. Instead of being centralized at headquarters, it was spread throughout the business units, where it could more easily be co-opted by hard-driving executives. "The business people didn't want to slow down for much," says one former in-house lawyer.

Central to forging a new Enron culture was an unusual performance review system that Skilling adapted from his days at McKinsey. Under this peer-review process, a select group of 20 people were named to a performance review committee (PRC) to rank more than 400 vice-presidents, then all the directors, and finally all of Enron's managers. The stakes were high because all the rewards were linked to ranking decisions by the PRC which had to unanimously agree on each person. Managers judged "superior"—the top 5%—got bonuses 66% higher than those who got an "excellent" rating, the next 30%. They also got much larger stock option grants.

Although Skilling told Harvard researchers that the system "stopped most of the game playing since it was impossible to kiss 20 asses," other Enron managers say it had the opposite effect. In practice, the system bred a culture in which people were afraid to get crossways with someone who could screw up their reviews. How did managers ensure they passed muster? "You don't object to anything," says one former Enron executive. "The whole culture at the vice-president level and above just became a yes-man culture."

Several former and current Enron execs say that Andrew S. Fastow, the ex-chief financial officer who is at the center of Enron's partnership controversy, had a reputation for exploiting the review system to get back at people who expressed disagreement or criticism. "Andy was such a cutthroat bastard that he would use it against you in the PRC," says one manager. He could



Her weather biz epitomized Enron pizzazz

filibuster and hold up the group for days, the exec adds, because every decision had to be unanimous. A spokesman for Fastow declined comment.

Although managers were supposed to be graded on teamwork, Enron was actually far more reflective of a survival-of-the-fittest mind-set. The culture was heavily built around star players, such as Clemmons, with little value attached to team-building. The upshot: The organization rewarded highly competitive people who were less likely to share power, authority, or information.

Indeed, some believe the extreme focus on individual ambition undermined any teamwork or institutional commitment. At other companies, by contrast, an emphasis on individual achievement is balanced by a strong focus on process and metrics or a set of guiding values. "In the Enron culture, there was no significant counterbalance," says Jon R. Katzenbach, a consultant and former McKinsey colleague of Skilling who has

studied the company. "The lesson is you cannot rely solely on individual achievement to drive your performance over time. Companies rely only that one path overemphasize it and run into trouble, switching over to value and greed."

That emphasis on the individual instead of the enterprise may have pushed managers to cross the line into unethical behavior. The flaw grew more pronounced as Enron struggled to meet wildly optimistic expectations for growth it had set for itself. "You've got someone at the top saying the stock price is the most important thing, which is driven by earnings," says one insider. "Whoever could provide earnings quickly would be promoted."

The employee adds that anyone who questioned the perfect deals quickly learned to accept assurances of outside lawyers and accountants. "It says there was little scrutiny of whether the earnings were real or how they were booked. The more people pushed the envelope with

aggressive accounting, she says, the harder they would have to push the rest of the year. "It's like being a heroin junkie," she says. "How do you go cold turkey?"

The problem is, you can't. "For most every model or system, there are certain limits," says USC's O'Toole. "It's harder to keep the growth growing to keep coming up with new ideas. That kind of culture has a subtle encouragement to cut corners and to cheat. You can see everyone else moving forward and you have to keep up."

Clemmons, who left Enron in May of 2000, isn't so sure. "It's quite clear that there were some accounting issues and bad decisions that had nothing to do with the trading side of the business," she says. "To distill it all down to a culture is utter bulls---."

As academics do their revisionist thing, they're not likely to agree.

By John A. Byrne, with Mike Frazer in New York and with Wendy Zellner in Dallas



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EDUCATION

THE TIME BOMB IN THE WORKFORCE: ILLITERACY

The fastest-growing groups in the U.S. have the worst skills

Ten years ago, what worried corporate leaders most was that U.S. competitiveness would be undercut by inadequate workforce skills. But those fears dissipated as the economy boomed in the late 1990s and productivity soared. Now, a new study raises troubling questions about the country's human capital once again, as well as about the failure of U.S. schools to keep pace in an increasingly competitive global economy.

The study, by the Princeton (N.J.)-based Educational Testing Service (ETS), finds that the literacy of American adults ranks 10th out of 17 industrialized countries. More troubling, the U.S. has the largest gap between highly and poorly educated adults, with immigrants and minorities making up the largest chunk of those at the bottom. Since both groups make up a growing share of the workforce, the U.S. will drop even further behind unless adult training and education improve sharply. Nor are U.S. schools likely to help: 16- to 25-year-olds not only underperform their foreign counterparts but also do so to a greater degree than Americans over 40 (tables).

The study illustrates how shortfalls in skills, experienced even in the midst of the current recession, are only likely to intensify as the economy picks up again. It also drives home the urgency of school reform. "We're living off the GI bill," says study co-author and Northeastern University economist Andrew M. Sum. "Our older workers still have a skill advantage, but other countries are catching up because their young workers are better prepared."

The ETS survey, which will be posted on the Web site ets.org on Feb. 15, represents the first time anyone has been able to consistently compare skills of adults across countries. It looks at tests done by 17 countries between 1994 and 1998. Using the same methodology, each country judged three aspects of functional literacy: understanding texts such as books and newspaper articles, using documents such as maps and bus schedules, and employing math skills needed

France, Britain, and Italy. (Japan did not participate.) The showing is particularly good in light of America's far more diverse population. The U.S. has more minorities, immigrants, and poor people than most participating countries.

But the results aren't much to boast about, either. The OECD divided the results into five proficiency levels based on widely accepted standards. While adults in any country are illiterate in the sense that they can't write their own names, those in the bottom levels can't read or write as well as a high school graduate. Fully 45% of Americans fell into this category, with most half of those, or 20%, scoring at the lowest level, which puts their literacy below that of a high school dropout.

Most of the problems show up among immigrants and minorities. Immigrants accounted for more than 40% of U.S. labor-force growth since 1990. But because many are unskilled, they rank

points behind native-born Americans. The U.S. also scored 16 points lower than newcomers in the other countries, which give preference to educated immigrants.

U.S. minorities score no better. Hispanics ranked as many as 14 points lower than whites, while blacks scored 63 points lower than Native-born whites. Asian Americans averaged 288 points, tying for second place in international rankings of understanding text. "Our school system failed minorities and immigrants, which is a problem for companies because that's who's there to hire," says Phyllis Eisen, head of the National Association of Manufacturers' education arm.

The U.S. has long generated greater gaps between rich and poor, at least partly from the belief that the economy grows faster when more rewards go to the talented and the entrepreneurial. But the expansion of a low-skilled underclass threatens economic growth, too. Unless the U.S. redoubles its educational efforts for those on the bottom, its global workforce disadvantage is likely to worsen.

By Aaron Bernstein in Washington

U.S. LITERACY LAGS BEHIND...

American adults' ranking among 17 industrialized countries, by test score

SCORE	U.S. RANKING
Top 10%	3rd*
Top 30%	5th
Average	10th
Bottom 30%	11th
Bottom 10%	15th

*The U.S. is statistically tied with Canada for second place.

**The U.S. is statistically tied with Australia for seventh place.

Tests given 1994-98. Other countries include Australia, Belgium, Canada, Denmark, Finland, France, Germany, Britain, Ireland, Italy, the Netherlands, New Zealand, Northern Ireland, Norway, Sweden, Switzerland.

...AND IS LIKELY TO GET WORSE

Americans' ranking among the same countries, by age

AGE	U.S. RANKING
56-65	5th
46-55	8th
36-45	8th**
26-35	15th
16-25	14th

Data: Educational Testing Service

to balance a checkbook or calculate a tip. The Organization for Economic Cooperation & Development (OECD) published the raw data in 2000, but the ETS is the first to analyze them. The outcome: The U.S. scored an average of 272 out of 500 on the three aspects, 32 points behind top-ranking Sweden.

Despite the mediocre U.S. ranking, it still beat out most of its major trading partners except Germany, including

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Information Technology



**CEO KUMAR
HAS TO BOOST
REVENUES
THROUGH INTERNA
INNOVATION**

OVERHAULS

A LONG CLIMB OUT OF A DEEP RUT

Computer Associates must win back alienated customer

Another day, another black eye. That's how it goes for Computer Associates International Inc., the Islandia (N.Y.) maker of software for managing computer networks. The latest jab came on Feb. 5, smack in the middle of CA's sale of \$1 billion in bonds, when Moody's Investors Service said it was concerned about weakening cash flow and would review CA's credit rating. CA's stock dropped 13.5% the next day. It canceled the offering. Furious, CEO Sanjay Kumar accused Moody's of "blindsiding" him. "What they did was unconscionable," he says.

The Moody's news comes at a crucial point in CA's 25-year history. Kumar is trying to shake off a series of blows that have pounded the company's stock down 62% from a peak of \$75 two

years ago. First came a blizzard of customer complaints about inattentive salespeople and overly rigid contract terms. Then there was confusion over the company's pro forma earnings. The capper came last summer when Tech entrepreneur Sam Wyly staged a proxy slinging, but unsuccessful, proxy battle to take control of CA's board.

Add it all up, and Kumar will be pressured to get the world's fourth-largest software company out of its rut. The Lanka native and 14-year CA veteran was appointed CEO in August, 2000, when combative Chairman Charles B. Wyly gave up daily operations. Kumar vowed to forgo the acquisitions that relied on to boost revenues, but he has not proven it can grow rapidly without them. Even analysts who rate the stock

ay CA will grow only by single digit years to come, vs. 30% growth in the 1990s. "It's not a rocket ship. modest grower," says Andrew Beau of SG Cowen Securities Corp. The situation could get worse. Moody's concerned about CA's ability to pay its \$3.6 billion in debt. The agency estimates operating cash flow will probably be \$1 billion this fiscal year, ending March, down from \$1.3 billion in 2001 to \$1.5 billion in 2000. That would make CA, the only major software company with sizable debt, with a debt-to-equity ratio of three to one. That ratio is on the high side of normal and could widen. "If their growth slows down a lot, they might be inclined to do an acquisition to grow and pay for it with more debt," says Moody's analyst John D. Moore.

Kumar denies CA's best days are behind it. He predicts it will return to double-digit growth—fed by demand for new technologies. And he estimates the cash-flow work. The company has paid down its debt by \$850 million this fiscal year. Kumar estimates the decline in cash flow from \$462 million in the fourth quarter of fiscal 2001 to \$454 million this year on an unusual \$200 million up-front payment made a year ago by a big customer. Typically, customers pay for products in installments over the life of multiyear contracts and pay finance charges on the unpaid balance. This customer chose to pay upfront and avoid the finance charges.

Kumar also claims that CA will not be hurt by the canceled bond offering, which he describes as a discretionary move aimed at reducing bank loans with long-term bonds that have 1% annually on interest. About \$1 billion in debt comes due over the next five quarters, but CA expects to pay it off out of cash flow.

The cash-flow debate is a piece of something larger: CA's wrenching switch in its basic business model. Starting in October, 2000, CA added a clause to new contracts allowing it to recognize revenue in equal increments over time. The goal is to smooth out wild ups and downs in earnings.

But the company got into hot water. In April, it reported pro forma fourth-quarter profits of \$274 million, while under generally accepted accounting principles it suffered a loss of \$410 million. The use of more revenue was deferred. CA compared the pro forma numbers by reconciling past and current results as if

CA had always deferred revenues. Analysts didn't entirely trust the results. "They're numbers created by CA and counted by CA," says RBC Capital Markets analyst Sarah Mattson.

Now, with five quarters of the new model under CA's belt, analysts say GAAP results show the finances are stabilizing. On Jan. 22, CA announced \$749 in revenues in its quarter ended Dec. 31, down 4% from a year earlier. That's better than rival BMC Software Inc.'s 17% decline. CA also reduced its loss from \$342 million to \$231 million. Analysts predict it will be profitable on a GAAP basis by the first quarter in 2003. The stock, now trading at \$28 per share, has come off a low last September of \$22. "We're 60% of the way there in remaking the company," says Kumar.

No doubt he has made progress. After being criticized for having a "rubber stamp" board during the proxy battle, CA is shoring up its governance. It's

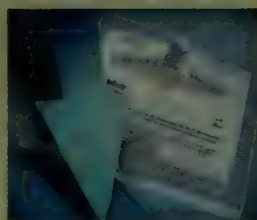
Corp—tell stories of Hyde-to-Jekyll culture changes at CA.

But some irate customers don't change their minds overnight. According to a 2001 customer-satisfaction survey, only 10% of large customers felt they had a "constructive" relationship with CA. That's in spite of the fact that it created a 650-person customer-relationship staff in 2000. Even K. Wade Tolman, the executive vice-president at KeyCorp who changed his mind about dumping CA last year, still has his reservations. "We're waiting for more proof," he says. "We want to make sure this isn't a flash, that it's a true change."

Unless customers start to like CA a whole lot better, the software maker is going to have a hard time getting revenues fired up again. What's needed is a burst of new technologies, and analysts don't see that coming. "They're not an innovating company. They make incremental changes," says analyst Herb Van

Kumar's Challenges

Computer Associates is attempting to get on track, but progress is slow



FINANCIALS

Revenues and profits are improving. But on Feb. 5, Moody's Investors Service said it was reviewing CA's credit rating, since its cash flow is declining.



CUSTOMERS

CA set up a 650-person customer-relationships staff in 2000 to please buyers. Only 10% of CA's large customers felt satisfied.



PRODUCTS

CA is forgoing major acquisitions and developing technologies internally. The glitch: R&D dropped 4% last quarter, to \$165 million.



CORPORATE GOVERNANCE

The board cut in half the 10-year term of its poison-pill takeover defense. But a search for outside directors hasn't yielded results.

looking for two new outside directors. And Kumar is making nice with critics. He agreed to meet with Stephen Perkins, who ran for a board seat on Wyly's ticket. "I appreciate their response," says Perkins. "But the company still has a credibility problem. There's a lot more that needs to be done."

And that's how it goes with CA. Take customer relationships. Kumar interceded last year to stop a dissatisfied Wal-Mart Stores Inc. from dropping CA's software. To show he was serious about patching things up, he sent salespeople to work in Wal-Mart stores for short stints. One rep was so gung-ho that he volunteered to mop out a vegetable department. "I saw a completely different CA," marvels Daniel F. Phillips, Wal-Mart's vice-president in charge of network operations. In addition to Wal-Mart, eight other customers—from Merrill Lynch to Key-

Corp. Hook of market researcher Meta Group Inc. Kumar insists CA can invent its way out of the no-growth zone. With a 20% market share, compared with IBM's 13%, it's the leader in software for managing corporate networks. It also has top-two positions in the fast-growing security and data-storage markets. Now, CA is adding to its products to handle wireless data and to support a new generation of applications called Web services.

What seemingly dooms CA to sluggishness is the fact that 47% of its product revenues are still linked to the old, slow-growth mainframe business. It's even more reliant on Big Iron than IBM is. Kumar may gradually buff up CA's reputation. But given the company's reliance on yesterday's products, he'll be hard-pressed to make it more about the future than about the past.

*By Steve Hamm
in New York*



MANAGEMENT TOOLS

THE SOFTWARE SAYS YOU'RE JUST AVERAGE

Technology alters how performance is gauged—and rewarded

During the boom, workers often shrugged off annual reviews as exercises in utter meaninglessness. Companies were so desperate to keep people that grade and bonus inflation ran rampant, creating a kind of corporate Lake Wobegon, in which all performances were strong and all cube dwellers above average.

Now, in the New Economy's first recession, the glow is gone as harsh reviews pummel grades, batter bonuses, and often turn the closed-door sessions into tense, stony-faced affairs. True, economists note lots of encouraging data supporting an upturn. But by then, many reviews will likely be altered for good.

That's because what was once a smushy, subjective effort by finger-in-the-wind managers is hitting new levels of scientific precision—with the help of the latest technology. More and more, companies are turning to Web-enabled employee performance software that allows them to analyze with cold, hard data just how effective their ranks are. Back in the 1980s and '90s, the focus was on business units, with compensation tied to the group's overall performance. Today, tracking software can zoom in on the finest-grained measure of an individual's output, so that everyone

from customer service reps to marketing execs can be paid in the modern equivalent of a piece-rate system.

Think of it as a kind of Six Sigma program for human capital. By identifying which workers are best at which skills, companies can quickly assemble the most stellar teams. The technology's performance data help managers identify whom to lay off, thus helping to cut costs and lift productivity—even in the midst of a downturn. Moreover, it's another tool in the emerging corporate star system, in which top players are lavished with rewards, while the middling make do with less. It was all part of the larger development in Corporate America of transforming labor from a fixed to a more flexible cost.

INSTANT REVIEW

Sales of new software that can tell the boss how hard you're working are soaring.

EMPLOYEE-MONITORING SOFTWARE MARKET

2001	2005*
\$100 million	\$2 billion

*Estimate

Data: AMR Research

UNDER SCRUTINY

Software monitors how British Airways' client reps book tickets

The methods are attracting a growing group of adherents, including Hewlett-Packard, General Electric, DuPont, and Microsystems. British Airways PLC uses the new software to ensure that customer service reps' time in the break room or on personal calls doesn't count on the clock. Customer complaint resolutions and ticket sales also are calculated. The technology can keep track of that extra incentive dollars eventually kicked directly

the paychecks of those whose dig records merit the boost. "We knew many hours our planes were on the ground or in the air—the productivity of our capital," says Steven Prune, British Airways' manager in charge of the project. "But we didn't have a fraction of that kind of information about the productivity of our other assets or our human capital."

While the technology—which is marketed by companies such as Synegy, Incent Systems, Workbrain, Replicon, and Informaworks—is most commonly deployed in customer service departments, it's reaching into other layers of comparison, too. At Hewlett-Packard, a new incentive calculator allows sales and marketing executives to see just how much they can earn if they double their goals. At Bayer, executives were able to instantly reconfigure incentive metrics after the September 11-related run on Cipro. Bayer was able to reap windfalls only when they were putting in extra physician hospital calls, not just riding on the unprecedented demand.

Critics say these developments take on an Orwellian cast. Some software experts predict companies soon will be able to blend the monitoring information they already have—like how much time their employees spend pleasure-surfing the Net, what time they arrive at work via their key cards, what they do when they get through concealed security cameras with the new goal data. If that happens, there will likely be a huge dust-up over employee privacy. But in the long term, the new technology is bound to make it easier for companies to sift out the coasters—as well as identify who the above average really are.

By Michelle Conlin in New York

Both can prepare you for the back 9 of life.
But only one can tell you if your 401(k) is on the right course.

Kevin Buckles
Meadow Club Golf Pro
Fairfax, CA



Mike Brogliatti
Schwab Investment Specialist
Campbell, CA



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MARKETING

GOING FOR GOLD ON THE CHEAP

Sponsoring second-tier Olympic sports can be a bargain

Mike Cofrin of the U.S. Speedskating Team has had a golden experience in Salt Lake City, and he hasn't laced up a skate. Cofrin is the marketing director for U.S. Speedskating, and, so far, one of his athletes carried the U.S. flag in the opening ceremony of the Winter Games; another briefly broke a world record and won one of the first medals for an American athlete; still another won a bronze medal; and on Feb. 12, Casey FitzRandolph grabbed the gold in the 500 meters. Besides that, a speed skater with some of the sport's sponsors prominently displayed on his uniform was on the cover of *Sports Illustrated's* Olympic preview issue.

"That's the first thing I pull out of my briefcase," Cofrin says of the *SI* cover story. It's evidence that sponsors of out-of-the-mainstream sports can score big, too. After all, Cofrin says a full-page color ad in *SI* goes for more than \$200,000. "And a cover? Who knows what it's worth?" he asks.

Unlike the Visas, Cokes, and McDonald's of the Games—official sponsors that pay \$60 million apiece to own a piece of the five rings—plenty of well-known corporate names are getting an Olympic ride on the cheap.

Take Verizon Communications Inc. Since 1985, when it was known as Nynex, the telecommunications giant has been USA Luge's key sponsor, paying about \$1 million a year. "Without Verizon, we'd be dead," says top-ranked American luger Tony Benshoof, who pocketed a grand total of \$12,000 last year en route to his national title.

Verizon recently bought into the U.S.

Bobsled & Skeleton Federation, which also has backing from athletic-shoemaker Adidas, global shipper AIT Worldwide Logistics, and Advocare, a marketer of nutritional supplements. "Marketers are figuring out they have an opportunity to be the first man on the moon," says Scott Becher, president of Sports & Sponsorships Inc. in Miami Beach, which cuts deals for the bobsled and skeleton teams. "It's pretty uncluttered."

Dan Field, owner of Aurora Solutions & Wireless, a \$1.5 million computer serv-

BIG NAMES, NICHE SPORTS

Some of the corporate sponsors backing offbeat events

BOBSLED AND SKELETON

- Verizon
- AIT
- HK Systems
- Advocare
- Adidas

SPEED SKATING

- Tyco/ADT
- Nike
- Novell
- Dow
- Texaco

"As a larger sponsor in a smaller group [of sponsors]...you get more of an affiliation with your sport," says Novell's B. Lowry. "Besides, it's good optics. Our products are about acceleration and speed, and so is speed skating." Included in the "several hundred thousand" dollars Novell laid down—a relatively cheap date for a billion-dollar company—was the right to put its logo on pre-Olympics uniforms.

Because corporate markings are allowed during the Games, except for apparel suppliers such as red-hot Nike (page 14), you'd think that would be a largely worthless part of the deal. But security giant ADT Security Services discovered, uniforms-as-billboards can deliver the sort of advertising bonus money can't buy. As speed skating's top corporate funder—with a four-year, \$1.2 million sponsorship agreement—ADT gets the most prominent location on skaters' skin-tight uniforms. That put ADT front and center when *Sports Illustrated* featured star short-track skater Apolo Ohno on its cover.

So maybe the corporate



AMERICAN GOLD MEDALIST: Casey FitzRandolph

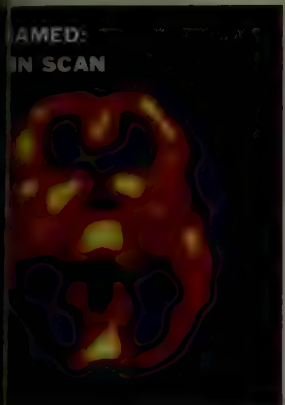
ice and sales outfit in Madison, Wis., knows from uncluttered. By providing about \$25,000 worth of free work for the U.S. Curling Assn., Aurora has become one of a handful of sponsors of a sport that can be loosely described as shuffleboard on ice. "What do you get for a million dollars anyway?" asks Field. "You get a little decal with the Olympic rings in your window."

Novell Inc., a software company based in Provo, Utah, bought into U.S. Speedskating last year to connect with its home-state Olympics.

behemoths that throw some \$13 million a year into the U.S. Ski & Snowboard Assn. and lavish more than \$10 million a year on the U.S. Figure Skating Assn. need to ask themselves a simple question: How much bang are we really getting for all those big bucks?

By Jay Weiner in Salt Lake City and Mark Hyman

ED BY ELLEN LICKING



IT'S BEHIND THE NIGHTMARE PAIN

SOURCE OF THE INTENSE pain of migraines has eluded scientists for years. Now, researchers at Boston's Massachusetts General Hospital have evidence that the pain can be caused by the brain, even though brain tissue is believed to be unable to feel sensations. Their research is published in the January issue of *Nature*.

The researchers, led by biologist Dr. Michael A. Cowitz, looked at the 15% of migraine sufferers who have "auras"—visual disturbances such as flashing lights before an attack. Using PET scans to make highly detailed pictures of the brain during such events, the team discovered that auras were linked to a disturbance deep in the brain called cortical spreading depression, which triggers a massive release of chemicals.

These chemicals cause inflammation and increased blood flow on one side of the brain's outside membrane. As a result, blood vessels feeding the membrane dilate, irritating the nerves. "We now know that after intense metabolic and neurophysiological activity, the brain not only processes the information but also, in this instance, generates the pain," says Cowitz. Catherine Arnst

SOON, AN OINTMENT THAT WORKS LIKE VIAGRA?

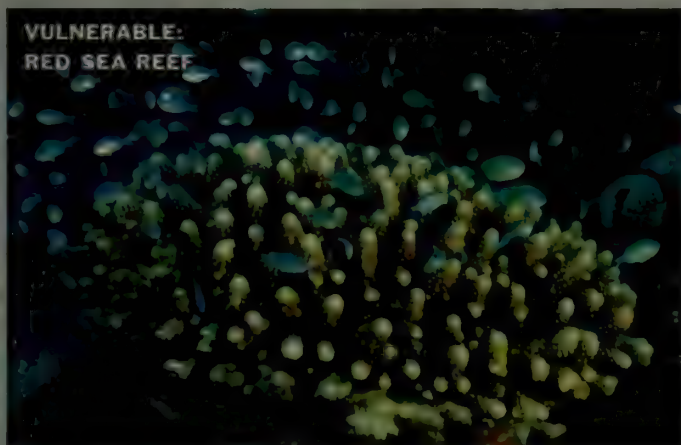
VIAGRA IS ABOUT TO GET SOME serious rivals. This summer, Eli Lilly & Co. and Bayer are both planning to introduce new—and potentially better—remedies for erectile dysfunction (ED). But perhaps more important, NexMed Inc., a pharmaceutical house in Robbinsville, N.J., is developing a topical cream, Alprox-TD, that represents a

new approach to treatment.

Because it is applied locally, Alprox-TD avoids the side effects that trouble some Viagra users, including blurring of vision and headaches. And it gets around drug-to-drug interactions of the sort that have harmed some Viagra users who take nitroglycerin for heart conditions. One other advantage: NexMed's cream appears to act in minutes, not hours.

The main ingredient in NexMed's cream isn't new. It is alprostadil, an off-patent

drug that has been used in the past as an injectable treatment for ED. NexMed has reformulated the medicine so that it can be absorbed through the skin. Earlier this month, the company started a pivotal clinical trial with Alprox-TD among 2,500 men at 80 medical centers in the U.S. NexMed's vice-president for R&D, Dr. James L. Yeager, says the company plans to wrap up the trial later this year and submit its results to the Food & Drug Administration by 2003. ■



CORAL REEFS IN THE DANGER ZONE

SHATTERED BY DYNAMITE-HURLING FISHERMEN, POISONED by agricultural runoff, or simply warmed to death by rising ocean temperatures, coral reefs around the world are losing their color and their fish. Yet some marine biologists continue to argue that the species living in and around coral reefs are in no danger of extinction. The sheer scale of the earth's oceans ensure that most species will survive somewhere, they say.

Maybe not. According to a survey of reef systems around the world, the slow death of geographically isolated coral reefs could destroy major concentrations of species, threatening the ocean's biodiversity. These "hot spots" are home to 34% of the world's restricted-range marine species—those seen nowhere else. The findings from the Center for Applied Biodiversity Sciences, an arm of Washington-based Conservation International, appear in the Feb. 15 issue of *Science*.

Still, the CABS report sees reason for hope. In the Philippines, for example, environmentalists have been pushing local fishermen to replace dynamite and cyanide with less destructive fishing methods. Reefs and fish stocks are already rebounding, says Callum Roberts of the University of York in Britain. The greater challenge, he says, will be stemming the devastation caused by coastal development and global warming. Adam Aston

A CHEMICAL'S SWEET TOOTH FOR POLLUTANTS

ENVIRONMENTAL CLEANUP IS becoming a sweet proposition. This coming May, a national team of researchers will use a type of sugar called cyclodextrin to clean up a contaminated military installation near Norfolk, Va. Unlike other decontaminants, which are often as noxious as the chemicals they seek to remove, cyclodextrin is safe enough to eat.

Found in cornstarch, cyclodextrin is chemically different from the white stuff people put in their coffee. It is composed of seven glucose molecules that can instantly latch on to trichloroethylene (TCE) and other organic contaminants in the soil. So cleaning up a site is simply a matter of injecting the sugar into the ground, letting it bind with pollutants, and pumping it back out.

Thomas Boving, the University of Rhode Island researcher in charge of the cleanup, estimates that it will take nearly 13 tons of cyclodextrin to remediate the military site. That might have meant a hefty price tag, since cyclodextrin costs \$3.50 a kilogram. Fortunately, Boving has figured out a way to strip the sugar of its contaminants and reuse it. ■

MOVING MORE JUICE THROUGH THE WIRES

Superconductivity could shave billions off energy bills

Jackhammers chewing through pavement. Barricades around trenches forcing two lanes of traffic to merge into one. Those are two of the ever-present growing pains that all cities suffer—but they could become less irksome because of what's about to happen in Detroit.

Perhaps as soon as summer, Detroit Edison Co. will launch service to 14,000 downtown customers through three 120-meter-long power cables, the likes of which have never before been used by an urban utility in the U.S. The cables are made not with copper wire but with a flat, ceramics-based wire that turns superconductive when the cables are cooled by liquid nitrogen flowing through their cores. One superconducting cable can carry three to five times more power, so power utilities can meet new demand just by pulling out a copper cable and inserting a ceramic one—without ripping up streets.

Moreover, electricity zips from end to end of a superconducting cable with essentially zero resistance. Copper cables, by comparison, lose roughly 7% of the power they transmit due to electrical resistivity. Tack on similar losses from electrical motors, generators, and transformers, and more than 8% of all generated power simply vanishes—dissipated as heat.

While 8% may not seem like much, given America's enormous appetite for power, it's worth billions—and billions more in Europe and Japan. That's why the Energy Dept. and foreign govern-

ments have been pumping millions into research on superconductivity since shortly after IBM researchers discovered the first high-temperature superconducting (HTS) materials in 1986. These oddball ceramics sparked plenty of dreamy-eyed promises in the late 1980s. Now, it seems they could soon start coming true.

Detroit is just one example of the major progress in HTS technology over the past two years. Southwire Co. got the ball rolling in January, 2000, by switching on the first industrial HTS transmission system at its home base in Carrollton, Ga. For 12,700 continuous hours, three 30-meter-long HTS cables have funneled all the power to the company's three Carrollton factories, with nary a glitch. Southwire made the cables with HTS wire from InterMagnetics General Corp. and technical help from Oak Ridge National Laboratory.

Last May, Copenhagen beat Detroit to the punch by "energizing" the first HTS cable in a utility grid. A 30-meter cable from Denmark's NKT Group now provides electricity to 150,000 residents served by Copenhagen Energy. Some Paris customers of Electricité de France are slated to get power from a similar HTS project this year.

Also in May, Tokyo Electric Power Co. turned on its third HTS project, using 100 meters of cable from Sumitomo Electric Industries Ltd., and the utility is planning a 300-meter operation for 2005. By far the longest installation anywhere—800 meters—is being de-



signed by a group led by Pirelli Cables & Systems and KeySpan-Long Island Power Authority. It is due online in 2004. And next year could see the start of two more urban tests—one by Edison of Milan, Italy, and another in Columbus, Ohio.

These milestones all have been heavily subsidized by government agencies. But HTS experts assert that business could be reaping payoffs by 2004 or 2005. Then, motors made with HTS materials could more efficiently pump through pipelines, drive factory machinery, and propel large ships. Biomagnetic-resonance imaging systems could shrivel in size and cost, move MRI out of hospitals and into doctor's offices. Electronic signals could zip through telecommunications equipment and mainframe computers up to 100 times faster. And there would be no need to burn fossil fuels to generate the juice that's now wasted.

Because U.S. utility execs tend to be very conservative, Energy is counting on Detroit "to establish the viability of superconducting cable in a crowded urban location," says David K. Garman, an assistant secretary at the Energy Dept. That's important because cities are one place where the high cost

THIN LINE: HTS wire on a pencil

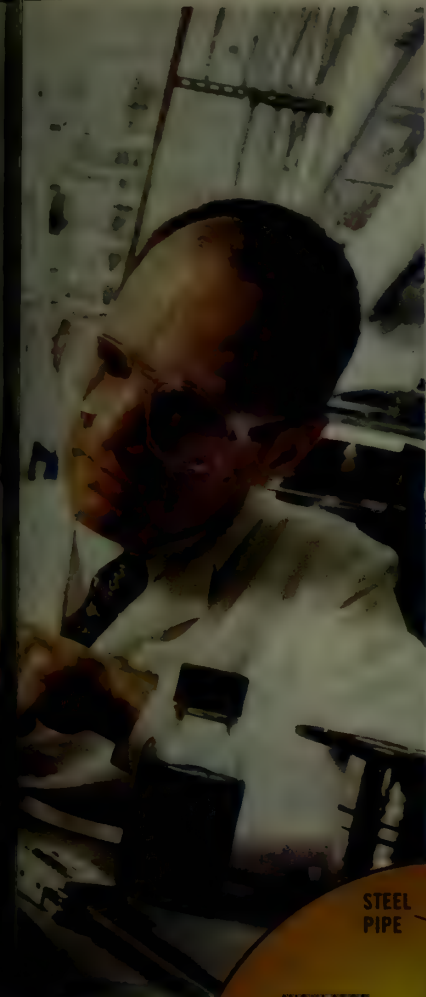
Saving Energy with Superconductors

Roughly 8% of all electricity in the U.S. goes up in smoke—actually, heat—thanks to the resistivity of copper and aluminum wires. Trimming those losses with superconducting materials could produce huge benefits.

APPLICATION	NET SAVINGS*	ANNUAL WORTH
Urban power cables and transformers	0.2-2%	\$4 bil.
Large motors** (over 1,000 hp)	1-2%	2 bil.
Power generators	0.5-1%	2 bil.

*After cooling costs, and assuming nationwide adoption

**These motors use about 30% of all electricity in the U.S.
Data: Energy Dept.



AT A PREMIUM: HTS wire now costs about \$200 a meter, vs. \$4 for copper

vs. \$4 for copper. Still, that's a fraction of what it cost in 1995: \$1,000 a meter. American Superconductor says costs will gradually drop to \$50 after it kicks off production at its new \$85 million factory. The highly automated plant can spew out 20,000 kilometers of HTS wire annually—40 times current output.

Producing HTS wire seems simple enough: Fill a silver tube the diameter of a tennis ball with "bisco," the nickname for ceramic compounds consisting of bismuth, strontium, calcium, and copper oxide (BSCCO). Then heat the tube and pull it through a series of progressively smaller holes until it's about 1 millimeter thick. Finally, roll it flat. "Basically, we take spaghetti and make fettuccini," quips Gregory J. Yurek, president of American Superconductor.

However, developing that recipe took countless hours of trial-and-error tinkering—in part because scientists still can't explain why HTS materials do what they do. So theoretical models offer little guidance in optimizing material compositions and processing.

IBM's 1986 discovery

Much more tinkering lies ahead. One challenge: HTS wires lose their vaunted high-temp powers in the presence of magnetic fields, although superconductive properties can be restored with further cooling. Since all motors and generators produce magnetic fields, HTS models using bisco wire will have to be cooled with expensive helium—until newer, second-generation HTS materials can be produced in volume. That work is underway at Energy's national labs, as well as a score of universities in Europe, Japan, and the U.S.

HTS experts also hope the new materials can slash costs to \$10 a meter, which is considered the trigger price for widespread use. Today's bisco wire will never get that low, because "it just uses too much mint-grade sliver," says Philip J. Pellegrino, president of IGC-SuperPower, a subsidiary of Intermetals General. The most common second-generation recipes substitute a nickel alloy for the silver, and YBCO ceramics—short for yttrium-barium-copper oxide—for bisco.

The trouble is, producing YBCO wire is proving far tougher than bisco. Expensive coating methods, adapted from the semiconductor industry, deposit several

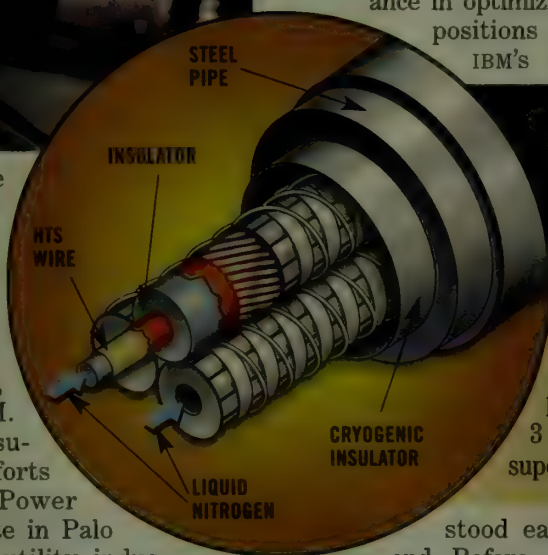
layers of superthin materials—almost as if the flat wire were a superlong chip. Doing this for a meter is no sweat, says EPRI's Grant, "but even 10 meters is a *tour de force* today." Grant is cautiously optimistic that solutions for volume production will be found. Meanwhile, Yurek is working with researchers at Massachusetts Institute of Technology on a process that mimics the production of

cables—some times that of er—can be fied. To sat-growing de- ds for power, n utilities two options, s Paul M. t, head of su- onducting efforts he Electric Power earch Institute in Palo

, Calif., the utility indus- research arm: "Either you tear he streets, which can cost a small ne, or you put in new cables that carry three times the power of ex- g cables."

etroit Edison chose the latter. It bed the ends of nine copper cables ghing 18,000 pounds and hauled n out from their underground ducts. n it threaded HTS cables weighing 250 pounds into three of the ducts, ing six ducts for future expansion rental to telecommunications iders. To braid the cables, Pirelli 29 kilometers of wire from Amer- Superconductor Corp., the leading olier of HTS wire.

TS cables may make economic sense er city streets, but nowhere else. A er of HTS wire that can carry a 0-ampere current costs about \$200,



In the Pipeline

Making HTS wire requires exquisite care. Tiny grains in the ceramic's crystalline structure must line up with precision: Any gaps more than 3 atoms wide will impede the superconductive rush of electrons.

stood earlier theories on end. Before, superconductivity had been mainly a frigid curiosity: Metals turned superconductive only when cooled with costly liquid helium to temperatures well below -400F. Physicists can explain that. However, even after 15 years of struggling, they are still puzzled by superconductivity in ceramics at relatively balmy temperatures above -300F.

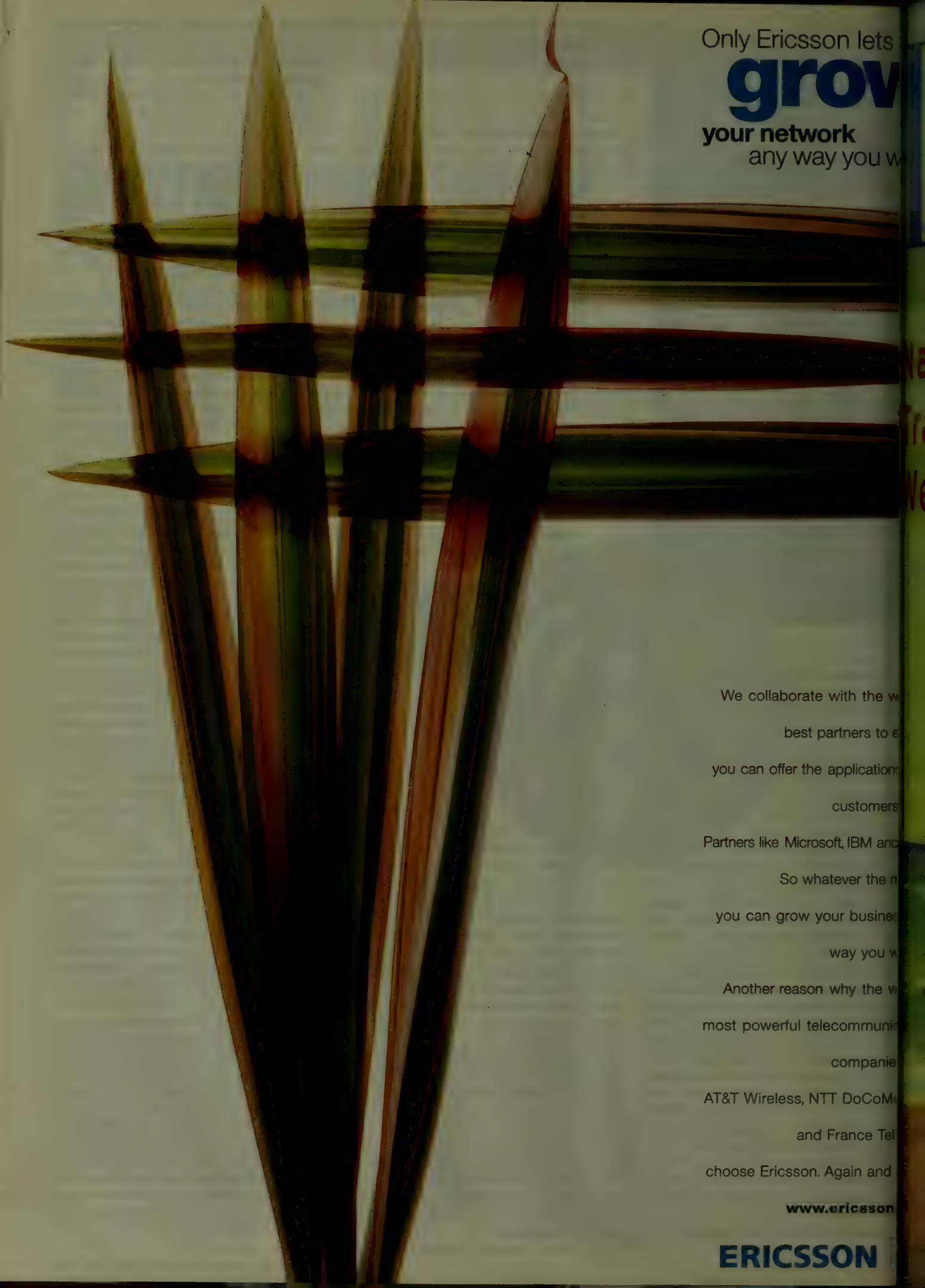
For engineers, though, HTS materials were a revelation. Liquid nitrogen can reach such temperatures easily, and it costs less than bottled water. So harnessing superconductivity suddenly looked feasible. Then they learned that making HTS wire requires exquisite care. The microscopic grains within the ceramic's crystalline structure must line up with atomic-level precision. Any gaps wider than 2 nanometers, or about three atoms, will impede the superconductive rush of electrons.

photographic film.

Because the new materials are relatively immune to magnetic fields, they are key to HTS motors and generators, says Martin P. Maley, chief superconductor scientist at Los Alamos National Laboratory. Big motors gobble up lots of wire. The rotor inside a prototype 1,000-horsepower HTS motor, built in 2000 by Rockwell Automation's Reliance Electric unit, contains several kilometers of HTS wire. Such monster motors consume 25% to 30% of all the electricity generated in the U.S., so industrial owners will have a potent incentive to consider HTS models.

Physicists may remain stumped by HTS for a while, but that's nothing new. "Edison was ahead of the science of his time, too," says James Daley, Energy's superconductivity program manager. And today's HTS engineers are determined to follow in his footsteps.

By Otis Port in New York



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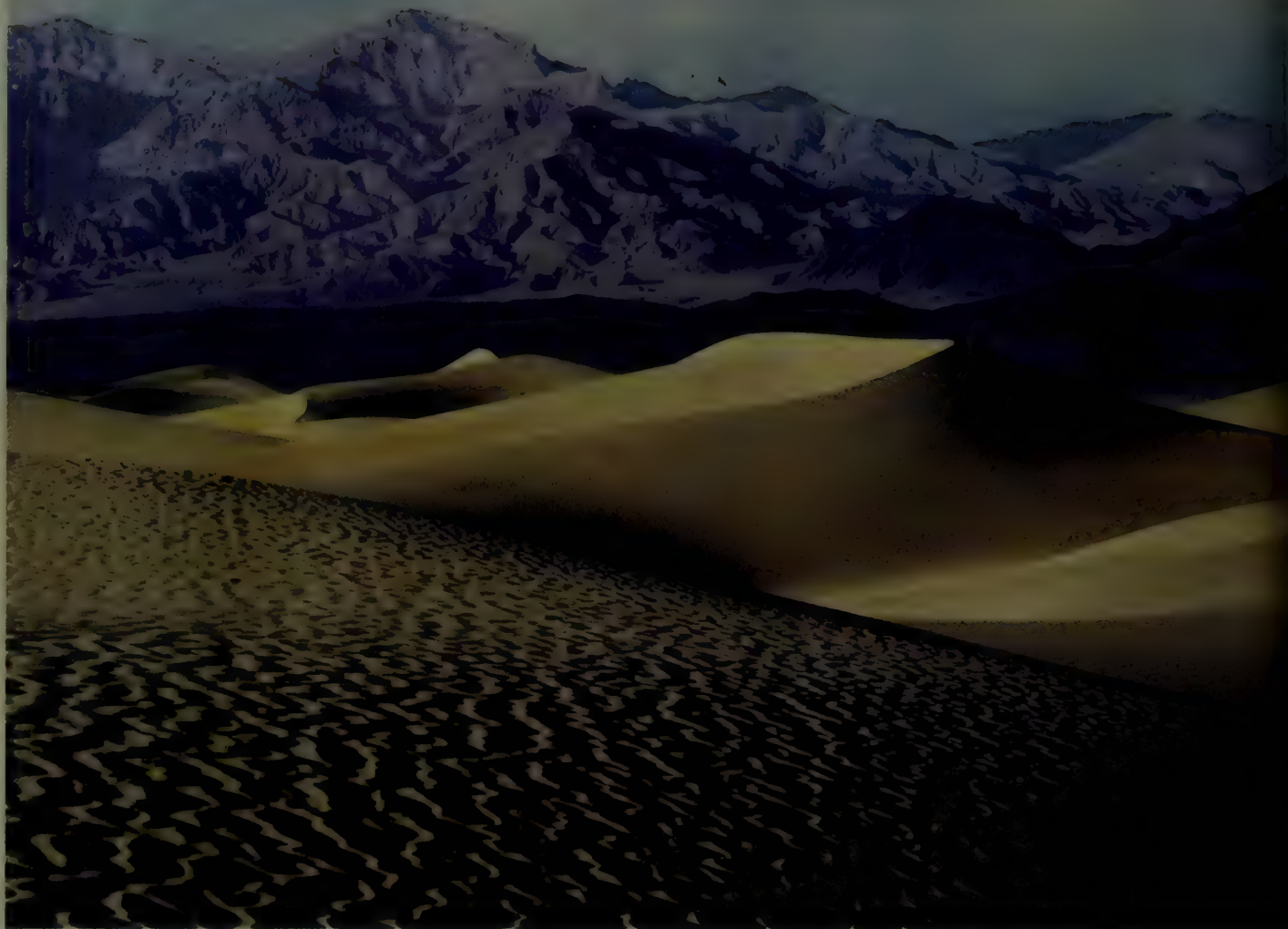
■ **The
Wonders of
Death Valley**

■ **Canada's
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■ **Funds:
Hidden
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■ **Barker:
Tyco's Sweet
Pay Package**





Living It Up In Death Valley

This hot spot offers much more than just sun

BY PAUL RAEBURN

Admittedly, the marketing leaves something to be desired: Death Valley doesn't sound like a place you'd want to go to relax for a few days—especially if you plan to return alive.

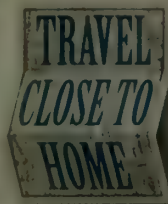
Don't be misled by the name, however. Death Valley is a place of surpassing, solitary beauty and surprising variety. Temperatures can reach 115F in the summer, but they're pleasant the rest of the year, with highs in the 80s and 90s in the spring and fall, and the 60s in January. (Nighttime temperatures can be 20 to 30 degrees cooler.) The land-

scape ranges from salt flats to strangely scrubby badlands, canyons, sand dunes, and mineral mountains in pastel shades of green, pink, and yellow. And unlike the early explorers and miners whose survival was always in doubt, you can enjoy Death Valley in rustic luxury, dining on rattlesnake empanadas as well as more conventional fare, and relaxing in a spring-fed pool where you can have a drink and admire a panoramic view of the valley.

Death Valley National Park, covering 3.3 million acres, is the largest national park outside Alaska. Situated in Southern California, just south of the Sierra Nevada mountains, it's a two-hour drive from Las Vegas, four hours from Los Angeles, and about eight hours from San Francisco. The valley, about 125 miles long and 50 miles wide, is the hottest, driest, lowest spot in North America.

At its nadir lies a blindingly white salt flat called Badwater, 282 feet below sea level. The water also happens to be only about 100 miles from the highest point in the continental U.S.—14,494-foot Mt. Whitney, within the park.

During most of its history, Death Valley has been filled with water. Ten million years ago, this simmering hot bowl was covered with lakes and forested hills and populated by deer, ho-



rhinoceroses, and dogs. Then earthquakes ravaged the area. Fractures in the earth's crust produced mountains and deep basins. A vast lake formed in Death Valley, with no outlet to the sea. When it evaporated about 10,000 years ago, it left large deposits of salt and borax, a mineral now used as a cleanser and water softener. In the 19th century, miners were drawn not only by borax but by deposits of gold, silver, copper, and lead.

The best way to explore Death Valley is on foot, although you will need a car to get to the trailheads. Despite the rugged terrain, many of the most spectacular walks and hikes take only an hour or two. A good place to start is Golden Canyon, a few miles south of the Furnace Creek visitors' center on Route 178. The canyon is framed by yellow walls that rise in some

takes you on a five-mile round-trip through the badlands west of Zabriskie Point, an overlook accessible by car and one of the park's most popular destinations. Hikers wind in and around small, softly rounded hills of bare yellow clay 50 to 100 feet high.

Another spot not to miss is Badwater itself, about 15 miles south of Golden Canyon. Most visitors stop at the salt-rich pool near the parking area, but a better bet is to lather yourself with sunscreen and walk 15 or 20 minutes out on the salt flats. Put on your sunglasses, too, because the salt reflects and magnifies the sunlight, which is intense to begin with. When you've ventured onto the flats, turn around and look up near the top of the cliff behind you. You will see a painted white line next to the words "sea level." It's an amazing sensation to realize that if Death Valley were still filled with water, you'd be almost 300 feet below the surface.

Because the landscape is so uncluttered, you can enjoy much of its beauty through the window of your car. On the other hand, if you're looking for more of a challenge, you can make the trek to 11,049-foot Telescope Peak, the park's highest point. It's 14 miles, round-trip, and you'll need to carry at least a gallon of water with you.

However you decide to enjoy the park, you can dine and relax in luxury at day's end at the Furnace Creek Inn, just up the hill from the visitor's center. Opened in 1927 by the Pacific Coast Borax Co., the inn is situated on a natural oasis, which feeds the swimming pool and nurtures a rich, green palm garden, improbably blooming in the middle of the barren wilderness.

The 66-room inn offers tennis, guided hiking, sightseeing, and 18 holes of golf on the world's lowest golf course—214 feet below sea level. (If your shots don't go quite as far as they should, you can blame it on the heavy air.) The rooms range from \$125 to \$365 a night, depending on the time of year, the size, and the view. Many overlook the garden and valley below. The restaurant offers Southwestern fare along with steak, a vegetarian dish, a cactus appetizer, and those rattlesnake empanadas. (No, it doesn't taste like chicken; more like beef.)

Motel-style rooms, starting at \$102, are available at the Furnace Creek Ranch in the valley and at Stovepipe Wells, where you can also find inexpensive restaurants. And there are nine campgrounds with about 1,500 campsites, though some are closed during the summer.

Rattlesnake isn't for everyone, and neither is Death Valley. But if you can understand the allure of a vast, uncrowded desert, this wilderness will captivate you with its serenity and breathtaking beauty. ■



It's an amazing sensation to realize that if Death Valley were still filled with water, at the salt flats you'd be almost 300 feet below the surface



FRESHING: Furnace Creek Inn sits in a natural oasis, which feeds the pool

The trail extends a mile or so to the top of Golden Canyon—about an hour's walk gently up a pebbly dry riverbed. If you're game, you can continue for a half mile to a spectacular theater of red rock walls, 100 feet high, known as the Red Cathedral. From the cool shade of the cathedral, you can look out over the valley, where the air is so clear that distances appear to be much shorter than they are. The only sound you're likely to hear is the wind's shuddering. City dwellers, note: The silence could unnerve those used to falling asleep to the sound of sirens and alarms.

A second trail from the top of Golden Canyon

Canada's Palatial Railroad Hotels

Built for grand travel, they are a bargain today

BY CAROL MARIE CROPPER

The first time I visited Canada, staying at a grand hotel was not an option. The best I could negotiate with my husband was one night with a bed and hot shower for every night spent stuffed in a sleeping bag on the ground. I still remember the sight of the 487-room Château Lake Louise as it beckoned like a fairy castle, the Canadian Rockies and Victoria Glacier rising in the distance behind. A modern-day Scarlett O'Hara, I pledged as I shivered in my tent: "I'll never be roomless again." Or something like that.

Since then, I have returned to Canada several times, staying in some magnificent hotels and dining in others. I was lured, in part, by a plunging Canadian dollar: At a recent value of about 63¢, it put a room at the Lake Louise as low as \$180 U.S. (table).

On that first trip more than a decade ago, I didn't know that many of these outposts of luxury were the product of the railroads. After steaming across the continent in the late 1800s, the Canadian Pacific Railway came up with its version of synergy: Its trains would bring the tourists, and its hotels would give them places to stay. William Cornelius Van Horne, a Canadian Pacific executive who lobbied for Canada's first national park, oversaw their construction.

One of the earliest hotels, the Banff Springs, sits in Banff National Park in the Canadian Rockies. It opened in 1888, and grew into what the railway describes as a baronial château style, full of dormered windows and fossil stone floors. Château Lake Louise followed in 1890, and gradually expanded into a sprawling hotel with 12-foot-tall Palladian windows framing mountain views.

As additional railroad lodges sprang up across the continent, Bruce Price, a student of the Richardsonian Romanesque style popularized by such buildings as Boston's Trinity Church, was brought in to design what would become one of the most recognizable icons of lovely old Quebec City: Le Château Frontenac. Perched high



CHATEAU LAKE LOUISE: A fairyland setting beckons

above the St. Lawrence River, with the French-speaking town at its feet, the hotel opened in 1893. It quickly became a stopover for celebrities and royalty. During World War II, Winston Churchill and Franklin D. Roosevelt met here to discuss strategy.

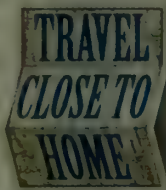
This past holiday season, my husband and I, now a bit older and flusher, shared glasses of Canadian ice wine in the circular, wood-paneled bar located in one of the hotel's turrets, looking down on the river and the twinkling lights of the town beyond. The next day, our brunch in the Le Château plain restaurant included rabbit in sorrel sauce and walleye pike with shrimp.

My first stay in one of the railway hotels came four Decembers ago, when I spent two nights at the Jasper Park Lodge in Jasper National Park. Developed by the Canadian National Railway, the hotel was acquired by Canadian Pacific in 1988. (Fairmont Hotels & Resorts now owns 13 of the historic railway hotels.)

The man behind the National's chain was Charles Melville Hays, general manager of what was then the Grand Trunk Railway. Hays was down with the Titanic in 1912, along with future headed for his maiden hotel, the Château Laurier in Ottawa. But his vision survived.

As at Le Château Frontenac, the Jasper Park's guest rooms are tastefully decorated and vary in size and view. The real show, however, is the public rooms, with their soaring ceilings, polished wood, and stunning vistas. Even a restaurant as simple as the Moose's Nook, where I had supper in the warmth of a great stone fireplace, seemed special.

As for my first love, Château Lake Louise, I'm still waiting for my room.



Luxury Up North

Turn-of-the-century grandeur in Canada is more affordable, thanks to a weak Canadian dollar. Some of the most majestic hotels, now owned by the Fairmont Hotels & Resorts chain, were built by the railroads.

BANFF SPRINGS

Banff, Alberta; 403 762-2211
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CHATEAU LAKE LOUISE

Lake Louise, Alberta; 403 522-3511
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JASPER PARK LODGE

Jasper, Alberta; 780 852-3301
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Quebec City; 418 692-3861
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* Seasonal rates in U.S. dollars for standard rooms; \$1 (U.S.) = \$1.59 (Canadian), based on Feb. 11 exchange rate

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Sailing America First

Cruisers discover new waters: The Great Lakes

BY JOANN MULLER

Charles and Amy Stephens have taken many cruises to exotic shores during their 40-year marriage. They've meandered around the Mediterranean, sailed the Danube River, and rounded South America's Cape Horn. Then, last summer, these world travelers embarked on a luxury cruise to a region that to them was unexplored territory: America's Great Lakes. "We just thought it would be nice to start seeing the U.S.," says Stephens, a San Marino (Calif.) businessman. "This is a wonderful way to do it."

Especially after the September 11 terrorist attacks, many Americans are discovering the pleasures of traveling closer to home. "We're finding people are coming to the Great Lakes because they're interested in a new itinerary that's right in their backyard," says Chris Conlin, president of Ann Arbor (Mich.)-based Conlin Travel, which sells chartered cruises through the lakes.



THE COLUMBUS: History lessons

Their trips offer spectacular scenery, rich history, and embarkation points that are easy to reach by air from almost anywhere in the country.

The newfound interest is helping a host of companies' efforts to revive passenger sailing in the inland seas. About a half-dozen ships now ply the waters May through October. While that's nothing compared with the heyday of Great Lakes cruising in the early 20th century, it's a change from just six years ago, when cruises were virtually nonexistent.

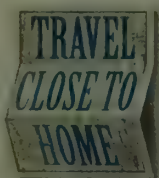
Travelers today can pick among itineraries that start in Chicago, Port Huron, Michigan; Windsor, Ont., Detroit's Canadian neighbor;

popular route goes from Toronto to Chicago, sailing into the Great Lakes—Lake Ontario, Erie, Huron, Superior, and Michigan. Along the way, the ships stop in big cities as well as in quiet, scenic spots such as Michigan's Mackinac Island and Whitefish Point, the quaint village of Little Current on Canada's Manitoulin Island, where passengers

are treated to a powwow by members of the native Ojibway tribe.

Unlike popular cruises to, say, the Caribbean, sailing on the Great Lakes is on an intimate scale. The ships are a lot smaller, the largest being the MV Columbus, which carries 420 passengers. Compare that with 2,758 for the Carnival Victory, one of the biggest in the fleet. Carnival Cruise Lines, which operates many Caribbean, Hawaiian, and Alaskan routes,

Because the ships often sail close to the shore, the Great Lakes cruises are conducive to nature watching. Fall color cruises are popular. For



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WHITEFISH POINT: Home of the Shipwreck Museum

gambling and the Vegas-style acts offered on most big boats. Entertainment on the Great Lakes ships is more subdued. You'll dine early—say, at 6—and then perhaps while away the evening in the lounge dancing to a German jazz band.

Fares, meanwhile, can be pricey. Seven nights aboard the Columbus range from about \$995 per person, double occupancy, for an inside cabin to \$4,400 for an outside suite, including meals, entertainment, and a room in a luxury hotel the night before departure. Airfare is extra, as are cocktails and shore excursions. Le Levant, a more luxurious ship with a capacity of just 95 passengers, offers eight-night cruises ranging from \$3,850 to \$5,525. By con-

trast, a seven-night, autumn Carnival cruise to the Caribbean would range from \$649 to \$1,049.

Oddly, Europeans were the first to reignite interest in the Great Lakes as a cruise destination, in the late 1990s. Hapag-Lloyd Group, a German shipbuilder, built the Columbus specifically to navigate the lakes' narrow locks. The ship is only about 70 feet wide, with its lifeboats built into the sides of the vessel. When the Columbus made its maiden voyage to the Great Lakes in 1997, it carried only German tourists. A year later, the French-built Le Levant also began sailing the lakes.

It didn't take long for the Americans to catch on. Three years ago, Conlin Travel teamed up with the European owners of both ships and now offers chartered cruises through a separate subsidiary, Great Lakes Cruise. While the ships

sail only in U.S. and Canadian waters, the crews are international, giving a foreign flavor to the experience. One odd twist: Because the ships fly under European flags, cocktails and items from the gift shops are priced in euros.

Lectures on nature and the region's rich history are popular perks on the Columbus and Le Levant, which generally offer two a day. Passengers learn how the five lakes were left behind after the last glaciers melted away more than 10,000 years ago. While there's plenty of breathtaking scenery to savor in the northern wilderness, passengers also learn about the role the lakes have played in U.S. commerce, from trading in the early 1600s to steelmaking today.

One of the most fascinating experiences during any Toronto-to-Chicago cruise is the four-hour trip through the Welland Canal in Ontario. The 26-mile canal linking Lake Ontario with Lake Erie was constructed in 1829 so ships could detour around Niagara Falls. Although passengers can disembark to visit the falls—taking a boat to catch the ship at the other end of the

canal—many prefer to stay on board and watch how a series of locks are filled with water to carry the ship up and over the cliff face of the Niagara Escarpment. That 1,000-foot cargo ship may be going through the locks at the same time makes the experience even more exciting. For Kirk and Susan Hays of Austin, Tex., the passage was a highlight of their trip on the Columbus last September. "You're all but 10 or six feet from the edge of the lock, so there's no margin for error," marvels Kirk Hays.

Nautical history buffs look forward to visiting the Great Lakes Shipwreck Museum at Whitefish Point, Mich., one of the stops in Le Levant's itinerary. Among the exhibits is a recently recovered bronze bell from the steamship *Mund Fitzgerald*, an ore carrier that sank in 1975 for still unexplained reasons, killing all 29 men aboard. Passengers don't need to disembark to view some of what the museum offers. As museum divers with underwater cameras explore a shipwreck, images and audio are live to Le Levant's TV screens.

The most frequent stop on Great Lakes cruises is Mackinac Island (pronounced Mackinaw), where bicycles and horse-drawn carriages are the only modes of transportation. Except for the tourists, the island looks much as it did in 1875, when Congress designated most of the island a national park. A highlight is a stroll along the 660-foot promenade of the Greek Revival-style Grand Hotel. In an era when some tourists are too frightened to set foot on an airplane, a trip back in time via the Great Lakes might be worth the ticket.



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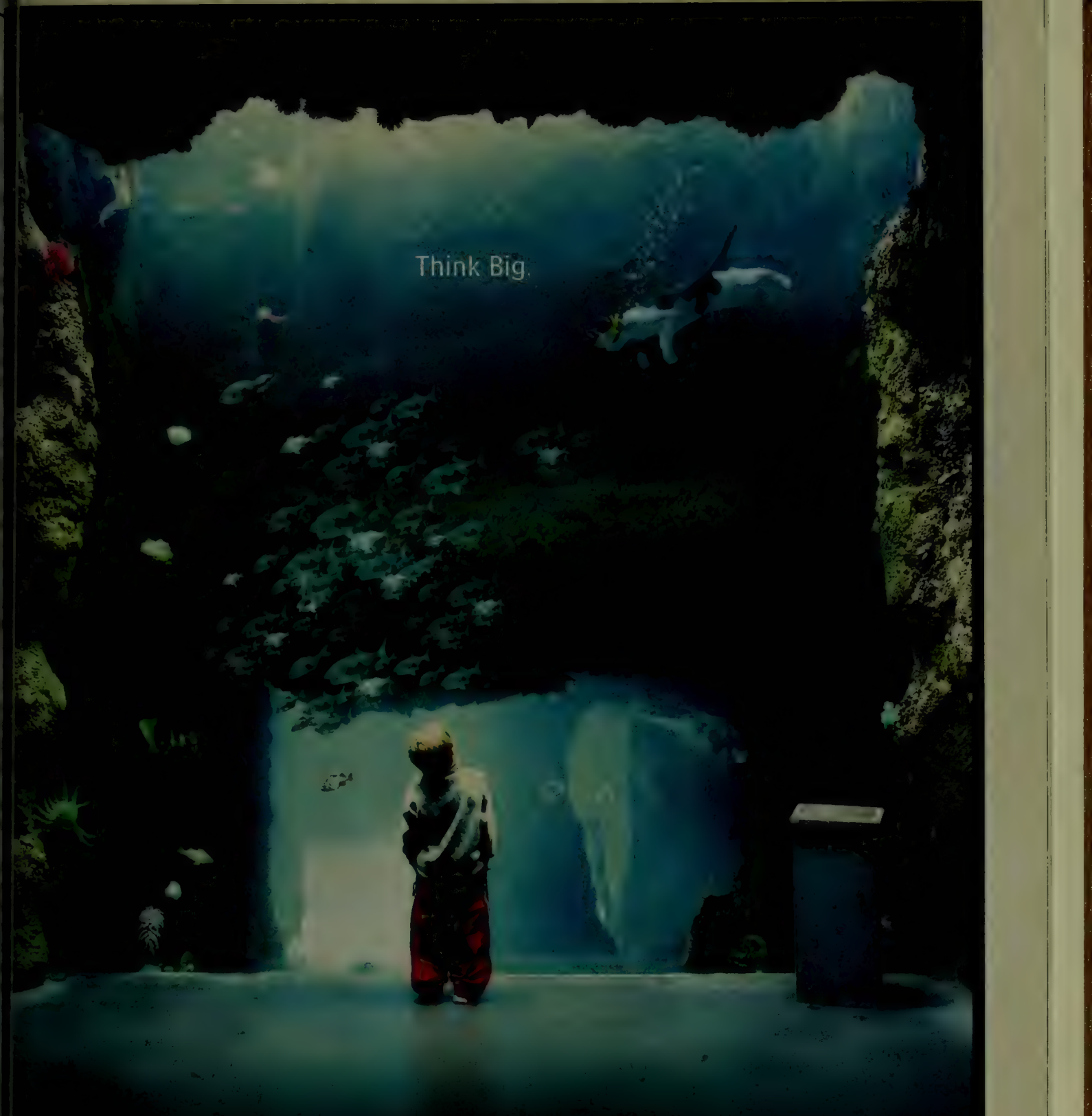
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On the Road with Rover

It's getting easier to take along your best friend

BY ANNE FIELD

Although a great many hotels accept dogs nowadays, most won't let you leave them unattended. Never fear: Pet sitters are available

Americans love their dogs—so much so, that many can't bear to leave their pet behind when they travel. As recently as a decade ago, that was a problem: It wasn't easy to find a place to stay away from home with your four-legged family member unless you were camping out or had tolerant relatives. But today, about 40% of hotels accept dogs, and a growing niche market caters to dog owners and their best friends, according to the American Hotel & Lodging Assn. One such establishment is the two-month-old Paw House Inn in West Rutland, Vt., which features a 1,000-square-foot doggie playhouse and special dog beds in each of its seven rooms.

As much as you might like the idea of taking your dog on vacation, bringing along an animal is no day at the beach—unless you do a lot of preparation. "Traveling with a pet is all about forethought and courtesy," says Walt Boyes, a Seattle marketing executive and corgi owner who is president of CorgiAid, a nonprofit group that pays for medical care and finds homes for corgi dogs. "If you think ahead and inconvenience people as little as possible, you will have a very nice time."

The first matter to consider is transportation. The trickiest option, of course, is flying. Generally, airlines allow two pets in the cabin with passengers, as long as they are 15 to 20 pounds

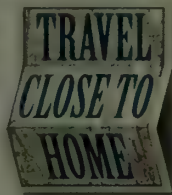
or less and travel in an approved crate that can fit under the seat. (That count as the one carry-on bag you're allowed, according to post-September 11 rules.) Bigger dogs must be transported in a crate roomy enough for the dog to stand up, turn around, and lie down. The crate goes in the luggage hold, in a special area that is heated and well-ventilated. Many airlines have upgraded facilities in accordance with new federal rules regarding animal safety. But the American Society for the Prevention of Cruelty to Animals still does not recommend putting animals in the luggage. No matter what the size of the dog, you need to make a reservation. Expect to pay at least \$75 extra.

Not surprisingly, 80% of trips over 100 miles taken with a pet are in a car, says the Travel Industry Association of America. But you can't just throw your dog into the back seat and expect a smooth ride. To be safe, veterinarians recommend keeping pets in a carrier or crate. You also can buy a special harness that attaches to a seat belt so the dog doesn't become a flying missile whenever the car stops short.

When it comes to lodging, your best bet is to plan in advance. A number of Web sites list pet-friendly places to stay (table). Be aware that policies vary widely. Franchises can be especially confusing, since owners set their own rules. The Super 8 in Dubuque, Iowa, for instance, charges an extra \$4, while the one in Rockledge, Iowa, doesn't allow pets at all.

Most places don't let you leave your dog in a room alone. The Cypress Inn in Carmel-by-the-Sea, Calif., which allows dogs in its 33 rooms as long as they're supervised, will hire a pet sitter for you. Otherwise, you can check sites such as petsitters.com for the names of local dog-watchers. Another possibility is a nearby doggie day-care center. The Common Dog in Everett, Mass., for one, looks after dogs in a 1,000-sq.-ft. yard. Its vans pick up pooches at one of three stops in nearby Boston.

What will you do with your dog when you arrive? Again, you'll have to do research. Some beaches and parks ban dogs, while others allow them only at certain hours. You might also want to check out places known to be welcoming to animals. One of the country's most pet-friendly locations is Key West, Fla., where beaches and restaurants admit dogs, and owners leave water bowls by their doors. Add a few fire hydrants, and your pet will be in doggie heaven.



Dog's Best Friends

DOGFRIENDLY.COM

Accommodations; pet-friendly events by states

DOGGIEDIRECTORY.COM

Doggie day-care centers and pet sitters

DOORTOSUMMER.COM

Dog-friendly activities, parks, and beaches in South Florida

HIKEWITHYOURDOG.COM

Links to 2,000 parks, plus rules for U.S. national parks

INTERPETEXPLORER.COM

Find hotels, motels, and pet sitters by city or state

PETSITTERS.COM

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PETSITTERS.ORG

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PETTRAVEL.COM

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Weekend Escapes: Use the Web

Local sites can help with short-hop trips

BY ELLEN
NEUBORNE

You don't need to go far to benefit from going online. The Internet may be the place to buy cheap airline tickets or research exotic locales, but it's also becoming a popular way to find nearby travel options. That's especially true as recession and terrorism fears have led many to vacation closer to home. I fired up my PC and began surfing for trips not far from my home in New York City after my family nixed a venture to Texas. I found the Net can do a lot to make a local getaway more fun.

Although big online sites such as Travelocity.com and Expedia.com offer lodging and activities in almost any good-size city, when you're traveling within 100 miles or so, it pays to consult a local site. Several travel sites devoted to individual cities and their environs can help (table). With their narrow focus and locally based staff, these boutique sites most likely have a vacation idea that would surprise even a native.

How do you find a local site? I used Yahoo! and Google, but other search engines work just as well. Just type in such keywords as weekend, getaway, and your city of choice. Also try searching the activities you'd like to do.

That's how Matt Sullivan of La Jolla, Calif., found Totalescape.com, a site dedicated to California vacations off the beaten path. His search on "mountain biking" turned up Total Escape, which specializes in active and outdoor trips. He ended up booking a four-day guided group camping trip at Anza-Borrego Desert State Park, 90 miles from Palm Springs. Total Escape arranged for the camp sites and the cooking and bonfire permits, provided driving directions, and matched up Sullivan, 31, with about 20 other like-minded vacationers.

Total Escape's Web master is its lead tour guide, and the weekend included optional excursions to nearby caves. Sullivan brought his own gear, so the trip cost him just \$25. While Total Escape focuses on outdoor fun, it also features inns and resorts, such as the Gingerbread Mansion Inn (\$130 to \$385 per night) in Ferndale in Northern California and the Blue Iguana Inn (\$95 to \$219) in

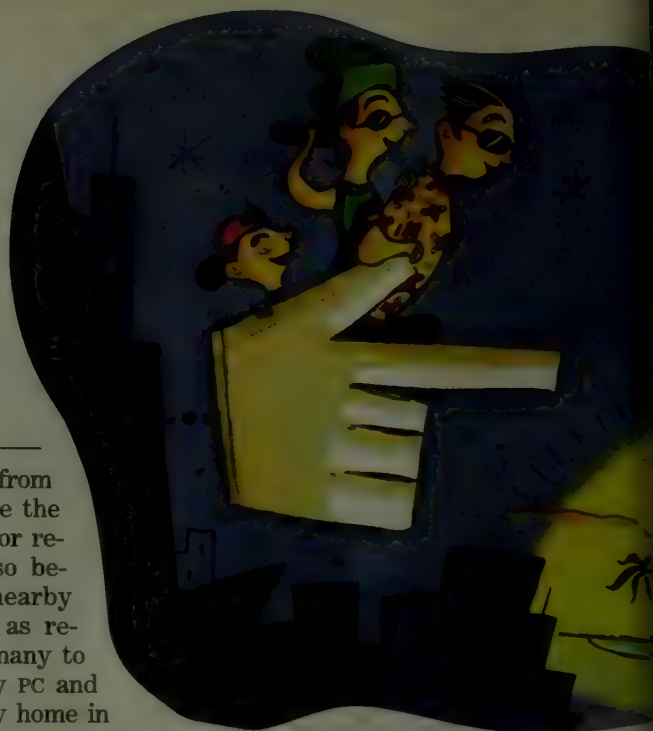
Ojai near Los Angeles. Hotel chains or amusement parks aren't listed.

I found my getaway by surfing Escapemaker.com, which specializes in trips within 500 miles of its Brooklyn (N.Y.) headquarters. When I searched for nearby environs such as Catskills, Hudson Valley, and Woodstock, on sites such as Orbitz, I came up blank. But Escapemaker directed me to the Hunter Inn, which is within walking distance from Catskills ski resort Hunter Mountain (\$79 to \$270 a night). The site also came up with a list of every specialty in Woodstock and the annual Chocolate Festival in Mystic, Conn. I decided a weekend of chocolate sampling—and a visit to the Mystic Aquarium—should help my family of four get over the disappointment of not being somewhere warm.

If you're willing to squeeze a plane trip into your getaway, Site59.com has made a specialty of packaging cheap airfares and hotels. Two recent offerings: \$277 from New York to Palm Beach with two nights at the Crowne Plaza Hotel, and \$303 from Washington to New Orleans with two nights at the Sheraton. Site59 is so good at quickie vacations that Travelocity and Orbitz now use it to purchase much of their getaway inventory.

The biggest drawback to smaller sites is uneven technology. While Site59 and the others are fully virtual from search to sale, Escapemaker provides only data and links. To book your trip, you'll have to pick up the phone.

The yen to travel locally may wane as the economy comes out of recession. Already, at Travelocity and Site59 say average trip bookings, which contracted after September 11, is inching again as consumers regain confidence in traveling. Still, when you get the urge for a quick trip, the boutique sites offer great resources to help you indulge your whim.



Planning Your Nearby Adventure

ESCAPEMAKER.COM Detailed

data on the 500-mile radius surrounding New York City.

Pros Good local knowledge and trips that don't involve airports.

Cons No online booking.

GORP.COM Encyclopedic content on outdoor and adventure travel.

Pros Many local travel options for 26 U.S. cities.

Cons Active vacations in the extreme. Couch potatoes, beware.

SITE59.COM Specializes in weekend and spontaneous getaways.

Pros Great selection, with trips leaving from 33 U.S. cities.

Cons Offers only packages, such as airfare plus hotel.

TOTALESCAPE.COM Info on outdoor adventures in California.

Pros Site owner has detailed personal knowledge of back roads.

Cons Trips are best suited for young travelers ready to rough it.

TRAVELOCITY.COM Online reservations for air travel, hotels, car rentals, and vacation packages.

Pros Travel to anywhere from anywhere.

Cons Best suited for the airline traveler rather than the local weekender.

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The Travel Agent in Your PC

An online odyssey can help you put together that special trip



BY ALEX SALKEVER

A search on Google.com found some 50 sites featuring B&Bs and private homes that can be rented on Maui

Before the birth of their first child last year, Chris Kenton decided to take his wife, Linda, on one last free-spirited vacation. Kenton, the president of a Bay Area tech marketing company called Cymbic, wanted to put together his own itinerary rather than buy a cookie-cutter tour. Even just a few years ago, that likely would have meant a call to a travel agent.

But Kenton used the Internet to book his Hawaiian vacation, a complex holiday that covered two islands, two hotels, a rental cottage, two rental cars, and inter-island flights as well as flights to and from San Francisco. He arranged all that in three hours, using a handful of travel sites. The result? A \$3,800 dream vacation that went off without a hitch. "I was able to preview every part of the trip," he says. "I knew exactly what to expect when I got there after see-

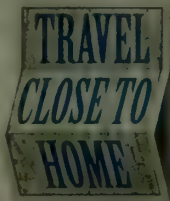
ing it online, and everything met my expectations."

Nowadays, more folks are donning the virtual travel agent hat. That's a big change from early days of online travel planning, when multiple-leg itineraries were difficult to arrange on slower computers. But with faster Web connections and better-designed pages, booking online is a snap.

That's not to say it's a one-click experience. Travelers will be sorely disappointed if they expect to find a single site that can help them arrange every aspect of a custom vacation.

Is there one established method to find the lowest rates and fares. For instance, while engines such as SideStep.com and FareChase.com pull in fares from several sites and provide side-by-side comparisons, they may miss new sections of a site offering special packages.

Although bidding site Priceline



aim to deliver the best prices, some travelers dispute this. Edward Hasbrouck, author of *The Practical Nomad Guide to the On-Travel Marketplace* (Avalon Travel Publishing, \$17.95), says fares on that site are no different and are often higher than what you could find from a travel consolidator such as Travelocity.com and Travelone.com. Consolidators offer lower rates on tickets or accommodations without paying the airline or hotel. That way, carriers can fill seats or rooms without competing on their own price structures. Priceline uses consolidator fares; the difference is that the consolidator rate is the starting point in Priceline's bidding process, says Hasbrouck. Travelers prefer to buy tickets at the publisher's—another option that allows them to pick carriers and the routes—they should check out travel sites, such as Travelocity.com, Expedia.com, and Orbitz. Hasbrouck, however, recommends that they use these sites merely to find the fare. They should then go directly to the airline site, he says, where they can buy the ticket for the same fare or sometimes lower. And they can often get bonus frequent-flier miles.

While your finger must do a lot of clicking, no one disputes that the Web is an invaluable tool that has revolutionized travel booking and research. Witness the path Kenton took to arrive at his itinerary. He and his wife envisioned a 12-day vacation that would allow them to see the sights of Oahu and Maui. While they wanted to enjoy the luxury of hotels, they also pictured themselves off on their own in Maui. Finally, they wanted to end their trip with a stay at Halekulani, a gem of a hotel right on Waikiki Beach.

Kenton started shopping for round-trip San Francisco-Honolulu fares at Travelocity and Expedia.com. He also checked Hawaii travel specialist sites like Hawaiian Holidays. But he found that fares on these sites either cost more than what he found on airline sites or didn't fit his schedule. He went up booking at American Airlines Vacations (aavacations.com), a subsidiary of the carrier, because it offered a flexible package deal. "Let me book a flight to Honolulu but get a hotel in Maui," he says.

From Honolulu, Kenton needed to get to Maui in 45 minutes away by plane, and back. For inter-island flights, Kenton used the Hawaiian Airlines site. Next, he started searching for a perfect rental cottage by the sea in which he could spend four of their eight days in Maui. A search on Google.com found about 50 properties featuring bed and breakfasts and private pools on the island. Most of them had pictures, rates, and availability dates. The Web was also allowed Kenton to check the surrounding areas for such things as population density, kinds of beaches, and proximity to restaurants. He decided on a bungalow in lush, secluded Hana on the northeastern tip of Maui that he found through Web site Hana Alii Properties (hanaalii.com).

For the final portion of their vacation, Kenton searched for sites that offered stays at the Halekulani. No sites carried the hotel except for the Halekulani's home page, so he used that to book a four-day stay. He then went to Avis.com to reserve a rental car on Oahu.

One thing Kenton didn't do on his online odyssey was book a kayaking trip. He looked at some sites but said he wasn't comfortable with the information he received. So he opted to wait for the locals' recommendations. For detailed information on specialized topics, such as good kayaking outfitters, it's best to post a query with online newsgroups, says Hasbrouck, because people in such groups are often savvy about the topic. You can easily find links to these groups through America Online, Google.com, and other search engines. Another option is to search for sites of travel agents that specialize in certain kinds of trips, such as painting tours of Tuscany or bike trips in Vietnam. Then e-mail your questions to these specialists.

Although the Web's vacation planning tools have multiplied, it's not the best medium for arranging all holidays. For instance, the cheapest place to buy international tickets remains the offline "bucket shops" that purchase big chunks of seats from airlines. "Ironically, these tickets often have fewer restrictions than the discount fares you can find online," says Hasbrouck.

As for cruises, some experts say the best way to book one is to talk to a travel agent. Why? They know the demographics of specific cruises, something that might not be clear from the descriptions on the travel sites. Bill Marbach, vice-president of sales at hotel discount site Lodging.com, says that travelers are often leery of booking a \$2,000 or \$3,000 package, such as a cruise, based solely on online data. "People want more info," he says.

A final caveat: Because you don't deal with a specific person, sometimes it's harder in the virtual world than in the real world to find someone to talk to when glitches, such as emergency booking changes, arise. Refunds and charges for changes can be problematic—so ask before you book. But if you're like Kenton, the ease and control you get from being your own travel agent is worth the risk. He's already planning his next jaunt to Hawaii, and he knows exactly where to look.

Your Online Travel Tools

GENERAL TRAVEL SITES

Expedia.com, Orbitz.com, Travelocity.com

Good for researching which carriers go where and at what price. Also, these sites may not have the lowest fares or the most detailed information.

CONSOLIDATORS

Hotwire.com, Priceline.com, Travelone.com

Offer the best domestic fares on the major carriers, but sites are not as comprehensive as those of the general travel sites.

COMPARISON ENGINES

FareChase.com, SideStep.com

These services search other sites. Nice way to compare published airfares and hotel rates side-by-side. But you may not get the lowest possible prices.

AIRLINES

Aa.com, Continental.com, etc.

You might find slightly lower fares than at general travel sites, since you're dealing directly with the airlines. Best place to get frequent-flier miles. Visit them to sign up for e-mails that advertise special deals.

HOTEL

Hoteldiscount.com, Lodging.com, Quikbook.com

Good places to find cheap rooms, though you may do as well or better to call a hotel's toll-free number. Quikbook focuses on upscale accommodations.

USENET

Google.com/groups

Sign up and post a query about a specific place, tour operator, or online travel service. A great way to get lots of quick feedback, and it's free.

THE DIRTY LITTLE SECRET OF MUTUAL FUNDS

BY LEWIS
BRAHAM

Regulators should probe deals in which mutual-fund companies pay high fees to be on a preferred list of funds that a broker recommends to its clients

When money manager Phillip Toews launched a new mutual fund last July, he thought he would have no trouble finding investors. Given the stock market's volatility, he figured his Toews Nasdaq-100 Hedged Index Fund would be a surefire hit. Yet two brokerage houses refused to let Toews contact their brokers about selling the fund. Why? He wasn't willing to pay to be on the firms' preferred list of funds.

Such "pay-to-play" arrangements are a dirty little secret of the mutual-fund industry. True, all fund companies pay to get a selling agreement with a national broker—and that can cost \$300,000 or so. But that money doesn't get a fund any attention—in other words, a place on the preferred list. Toews does have selling agreements with 30 different brokers, primarily regional ones where the initial set-up fees are small. Even so, because he's not on any preferred lists, the likelihood of investors hearing about his fund from brokers is slim.

These preferred list deals, though legal, are unfair to investors and are anticompetitive to many smaller fund companies. Regulators should investigate them, and either ban them or force fund companies and brokers to completely disclose their dealings.

Arrangements are always privately negotiated, but industry sources say getting on the preferred list starts with a higher sign-up cost, perhaps \$500,000 to \$1 million at national brokers. The fund company will then have to pay either a percentage of the brokerage's gross sales, about 0.25%, and/or an annual fee of 0.25% to 0.35% of the fund assets held at the company.

As distributors, brokers have a right to charge for shelf space—a common practice, for instance, in the food and publishing industries. But in mutual funds, preferred relationships create conflicts that can harm investors. Brokers may overlook funds that may be most suitable to an investor's needs. St. Louis-based broker Edward Jones can

sell funds of 180 fund families through its 70 branches. Yet only seven families—which include such powerhouses as American Funds and Fidelity—are on its preferred list. "Those seven are 97% of our business," says Thomas Miltenberger, the firm's fund marketing chief.

That's not surprising. "Once you're a preferred sponsor," says Toews, "your fund is discussed in their publications and included on their recommended buy list for their financial planners." Although Edward Jones charges extra fees for the preferred list, Miltenberger says it selects preferred fund companies based on product breadth and ability to service brokers—make office visits, distribute information and train brokers on how to sell their fund.

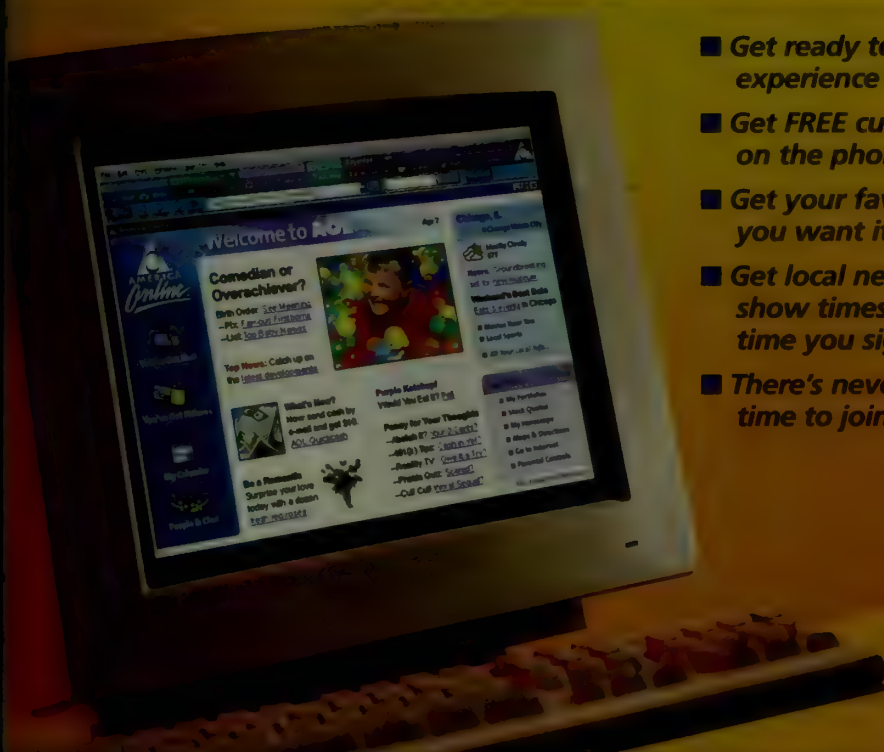
Servicing brokers is costly, too. "If a fund company comes to Merrill Lynch and says, 'We'll spend a lot of money to train your brokers on certain aspects of wealth management,' Merrill Lynch looks favorably on that, and increases competition for everybody else," says James Hawkes, CEO of Eaton Vance funds. Such training often takes place at cushy resorts. "A lot of firms will say, 'We want you to give us \$100,000 to attend our broker convention in Hawaii,'" says Joseph Rob, CEO of Sentinel Funds. "We rarely go to those."

So who's really footing the bills? Funds charge investors up to 0.25% of assets for distribution—it's part of the so-called 12(b)-1 fee—but that's not enough. Often fund companies tap into their own cash to cover pay-to-play costs. Since the payments are not from fund assets, the company is not required to disclose these costs to investors. But pressure on fund companies to protect profit margins means shareholders will bear some of the costs in the form of higher management fees. In fact, a 2000 survey of major fund companies by Financial Research, a fund consultant, found an average pay-to-play cost of 0.4% of every dollar invested in funds—a total of \$1.5 billion.

Why do fund companies agree to these ridiculous fees? Because they need brokers more than investors. Some 6,000 funds are competing for a place on the preferred list to get the fund's name in front of clients. Even so, investors need to know whether the funds their broker is recommending were among a handful that paid for preferential treatment.

Staff Editor Braham writes about mutual funds.

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THE HIGH COST OF KOZLOWSKI'S KEEP



BY ROBERT BARKER

rb@businessweek.com

Unlike the shares Kozlowski received in the past, the latest grant will vest year by year without Tyco having to clear any performance hurdles

Each time Tyco International's embattled chief, Dennis Kozlowski, answers one question lately, three more seem to pop up. Yet nobody second-guessed him during a Feb. 6 conference call with Wall Street analysts after he declared, "No one wants this stock to rebound faster than I do." Not counting his options on 10.4 million Tyco shares, Kozlowski had just seen the 3 million shares he owns outright plunge in value by \$108 million since Jan. 1.

That Kozlowski's interests and shareholders' interests are one and the same has been a tenet of faith among Tyco bulls. By most accounts, this has been true. Tyco stock has returned an average of 32.5% a year since he became CEO in July, 1992, vs. 13.7% for the Standard & Poor's 500-stock index. Just the same, it's now worth noting the appearance on Jan. 22 of a small rift in this rewarding communion. Kozlowski that day got 800,000 shares of restricted stock, given to him by Tyco's board of directors. Unlike millions of shares in stock Kozlowski has received in the past (table), this fresh grant will vest year by year without Tyco having to clear a single performance hurdle.

Investors can find the deal summarized in Tyco's Jan. 28 proxy statement and detailed fully in its Dec. 31 10-K filing with the Securities & Exchange Commission in an exhibit labeled "Retention Agreement." In return for Kozlowski's continuing service as CEO, the agreement calls for 100,000 shares to vest each January, 2002 through 2008. The eighth block vests on Nov. 16, 2008, his 62nd birthday.

When they were granted on Jan. 22, the full 800,000 shares were worth \$38 million at that day's closing price of \$47.55 a share. The 100,000 shares that vested immediately came nearly to \$4.8 million, and Kozlowski had the option to sell them right back to Tyco for cash. Mark Swartz, Tyco's chief financial officer, enjoys a similar retention deal, for 500,000 shares, worth almost \$24 million when granted. None of his is

set to vest until January, 2006, how

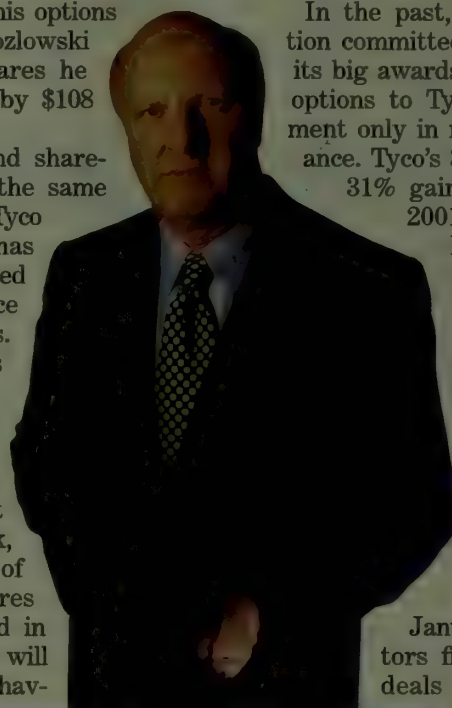
Why should Tyco shareholders give up a million in equity? "To make sure that we keep Dennis and Mark as key executives as long as possible," said W. Peter Slusser, president of a Manhattan investment firm, Slusser Associates, and a veteran of the Tyco board's compensation committee. Stephen Foss, chairman of the committee and CEO of fabric maker Foss Manufacturing, told me, "We kept getting asked by analysts, 'What golden handcuffs do you have?' Kozlowski and Swartz 'are top managers very attractive for companies to recruit.'"

In the past, however, Tyco's compensation committee has taken pains to ensure its big awards of cash bonuses, stock options to Tyco's top executives are payment only in return for superior performance. Tyco's 39% jump in net income,

31% gain in cash flow during 2001, for example, earned

Kozlowski a \$4 million bonus atop his \$1.65 million salary. The board last year also spurred him with 600,000 shares of stock. They vest over three years, but only if Tyco meets aggressive financial goals. This brand of performance-based pay has worked better than Tyco, Slusser told me. So why change course

January, 2001, when Tyco's directors first approved the retention deals without demanding any financial hurdles, Slusser calls they felt they "had to pay that price to make [Kozlowski and Swartz] stay." Yet since then much has changed at Tyco. It's now splitting into two companies with Kozlowski set to stay up as chief of an electrical and security-services unit half Tyco's size. Neither nor Swartz, who plans to stay as CFO, commented on it's an open question whether their deals are too rich for their new, more modest company. "It's something that will have to be discussed," Foss says. Investors saw Tyco sink 33% since these grants of stock. They want to ensure their leaders keep faith, taking only what they earn.



Lots of Extras

Beyond base pay, cash bonuses, stock options, and miscellaneous compensation, Tyco's board has granted CEO Dennis Kozlowski restricted stock that, until the latest grant, became vested only after Tyco cleared financial hurdles.

DATE OF GRANT	NUMBER OF SHARES	VALUE WHEN GRANTED
MAY 14, 1998	380,000	\$20,140,000
OCT. 18, 1999	624,000	25,707,178
JAN. 5, 2000	600,000	21,207,540
OCT. 1, 2001	600,000	30,398,880
JAN. 22, 2002	800,000	38,040,000*
TOTAL	3,004,000	135,493,598

*Estimate

Data: Company Reports, BusinessWeek estimate

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A REAL ESTATE MAGNET



BY GENE G. MARCIAL

Jones Lang LaSalle is attracting more global business. Rival gambling operators may bid for ailing WMS. Bio-Reference Labs looks robust after inking a Roche deal.

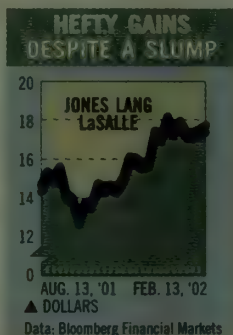
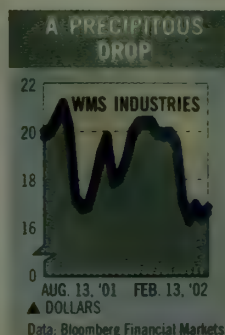
Value investor John Rogers Jr. thinks this angst-ridden market is a fine time to buy "solid franchise" businesses. He has stuck to that strategy at Ariel Capital Management in Chicago—where he's chairman and CEO—and it has worked: In 2001, Ariel's Mid-Cap portfolio posted a gain of 17.2%, compared with a loss of 11.9% for the Standard & Poor's 500-stock index and a 2.3% gain for the Russell Mid-Cap Value Index. Ariel's \$7.5 billion portfolio was helped by such stocks as International Game Technology, up 60% in 2001, and ServiceMaster, up 25.5%.

What's Rogers' favorite now? You've probably never heard of it: Big Board-listed Jones Lang LaSalle (JLL), a provider of real estate and investment-management services to multinational companies, including Microsoft, Bank of America, and Rockwell Automation. Jones serves not only as broker but also as manager for clients' properties worldwide. Multinationals now tend to outsource the operation of their real estate properties—a boon to Jones, says Rogers. Jones operates in 100 cities in 33 countries. Ariel has raised its stake in Jones to 17.7%, up from 6.2% in September. The stock hit a low of 12 in March, 2001.

Jones lost 55¢ a share last year, on sales of \$881 million, in part because of the economic slump. Now trading at 17, Jones sells at just over 10 times estimated 2002 earnings of \$1.65 a share, on revenues of \$900 million, notes Franklin Morton, Ariel's research director. In 2003, he sees earnings rising to \$2, on sales of \$955 million. Ariel's 12-month price target for the stock is 27.

WHO WILL BET ON WMS INDUSTRIES?

If Viacom CEO Sumner Redstone doesn't buy WMS Industries (WMS) soon, a leading Australian gambling outfit, Aristocrat Leisure, may just beat him to it. So argue several industry pros, who say the steep drop in WMS shares makes the producer of coin-operated video and gaming machines an attractive takeover target. Redstone, whose holding company National Amusements already owns 30% of WMS, continues to buy stock in the open market, now trading at 16.80 a share—down from its 52-week high of 32 in mid-June. Some analysts believe National Amusements will one day make a bid for WMS. The stock dropped after WMS was hit by a software problem in January, 2001, resulting in delayed state regulatory



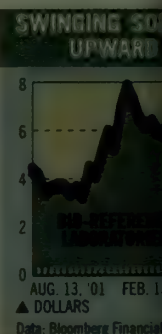
ry approvals of several of its new machines, house takes on its games, and order cancellations.

With WMS trying to resolve its problem, the company could become buyout bait, give "strong balance sheet [no debt and \$93 million cash as of Dec. 31, 2001] and its power censes and brands," says Jason Ader of Stearns. WMS is worth 20, he believes, and earn 78¢ a share for the year ending June 2002, and \$1.35 in 2003, down from 2001's. On Feb. 8, 2002, Ariel Capital Management reported to the Securities & Exchange Commission that it had acquired a 10.2% stake in WMS.

David Bain of Roth Capital Partners says Aristocrat wants to buy WMS: Aristocrat is set to "make a splash in the U.S. market and take on the industry biggie International Game Technology, which has 70% of the gaming-machine market. WMS has 11%, and Aristocrat 5%. Last year, Aristocrat was rumored to have approached WMS for a possible buyout deal. WMS, National Amusements, and Aristocrat weren't available for comment.

BIO-REFERENCE LABS IS IN THE PINK

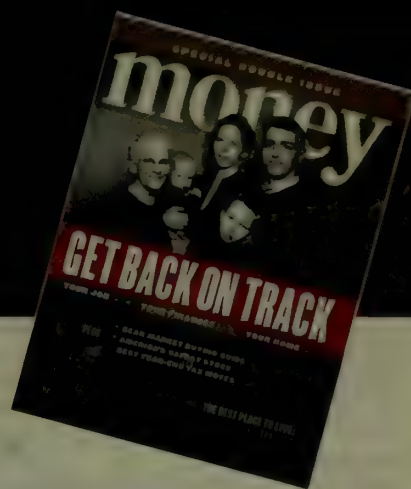
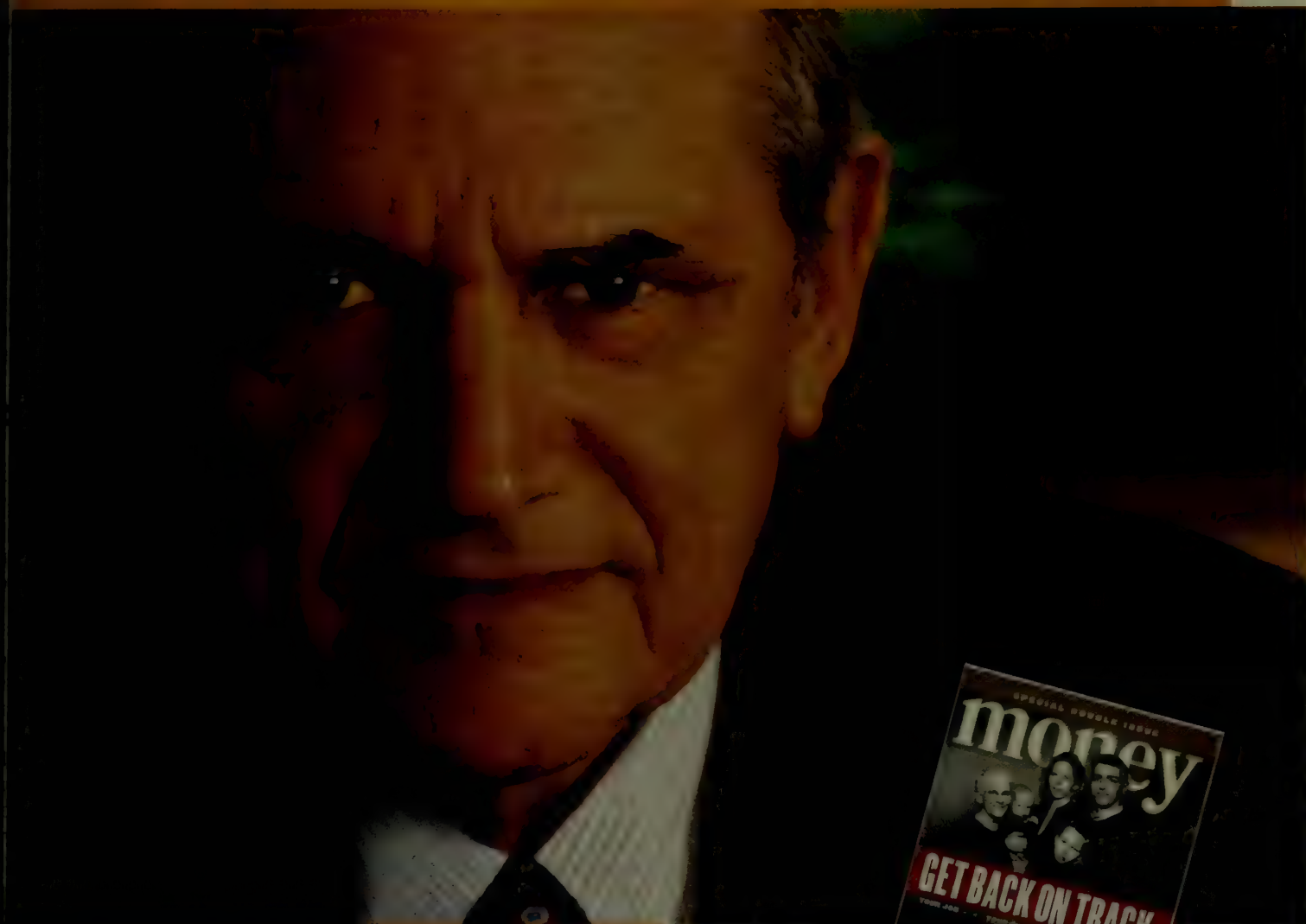
A regional clinical laboratory with no debt, following, Bio-Reference Laboratories has seen its shares surge from 3.45 in August to nearly 6 lately. One reason: It has been diversifying—and posting record sales and earnings. "Bio-Reference is our kind of stock," says Shelagh Hughes of Kennedy Capital Management, which manages \$1.6 billion. Kennedy owns 3% of Bio-Reference, or 2% of the total. "It is earnings-positive with a good growth story and no long-term debt. It's totally undiscovered and undervalued," says Hughes, adding that Bio-Reference is "attracting major labs." Based on recent deals, the stock is worth 9 in a buyout, says Hughes. The large dependent full-service lab in the Northeast, Bio-Reference specializes in genomics, oncology, and AIDS testing. On Jan. 22, 2002, Bio-Reference formed an alliance with Roche Group's Roche Diagnostics, whereby Roche invested \$1 million and will market and manage Bio-Reference's Net-based CareEvolve unit. CareEvolve provides doctors with a comprehensive system for lab reports, and it links doctors, patients and insurers to lift productivity. Hughes figures the company, which earned 24¢ a share on sales of \$80 million in the year ended October 2001, will post 20% annual earnings and revenue gains over the next two years.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see the column on Fridays at 1:30 p.m. EST on CNNfn's *The Money Game*.

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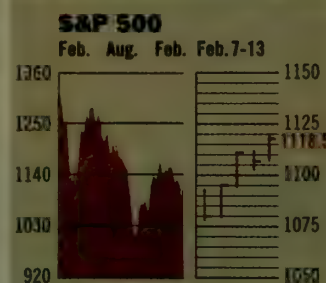
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Stocks



COMMENTARY

Valentine's Day arrived a day early this year when a Feb. 13 report of rising U.S. retail sales warmed investors' hearts. The Dow Jones' industrial average, up 3.5%, came within striking distance of 10,000, a mark not seen since early January. The S&P 500 and Nasdaq indexes climbed 3.2% and 2.6%, respectively. But markets remain wary: Witness stocks' narrow trading range.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Feb. 13	Week	Year to date	Last 12 months
S&P 500	1118.5	3.2	-2.6	-15.2
Dow Jones Industrials	9989.7	3.5	-0.3	-8.4
Nasdaq Composite	1859.2	2.6	-4.7	-23.4
S&P MidCap 400	506.0	3.5	-0.4	-3.0
S&P SmallCap 600	230.9	3.0	-0.6	0.4
Wilshire 5000	10,454.4	3.2	-2.4	-13.9

SECTORS

	Feb. 13	Week	Year to date	Last 12 months
BusinessWeek 50*	683.1	4.1	-6.4	-29.3
BusinessWeek Info Tech 100**	390.1	2.2	-7.0	-29.6
S&P/BARRA Growth	589.3	2.3	-0.9	-11.9
S&P/BARRA Value	528.7	4.2	-4.2	-18.8
S&P Energy	205.1	-0.2	-2.9	-13.7
S&P Financials	345.1	5.2	-2.9	-12.4
S&P REIT	93.7	0.6	0.3	9.1
S&P Transportation	208.2	2.0	5.7	-1.0
S&P Utilities	135.7	3.6	-7.0	-34.2
GSTI Internet	93.3	10.0	-11.1	-48.9
PSE Technology	671.7	3.0	-2.3	-19.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Auto Parts & Equip.	15.5	71.0
Forest Products	12.5	51.3
Trucking	12.0	37.7
Diversified Metals	12.0	34.7
Metal & Glass Containers	11.6	34.2

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Precious Metals	14.3	Precious Metals	55.4
Pacific/Asia ex-Japan	1.7	Real Estate	11.2
Miscellaneous	1.6	Small-cap Value	6.7
Diversified Emerging Mkts.	1.5	Mid-cap Value	0.6
Laggards		Laggards	
Communications	-11.3	Communications	-42.8
Technology	-9.2	Technology	-36.7
Utilities	-5.9	Japan	-31.7
Small-cap Growth	-4.5	Utilities	-24.9

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
First Eagle SoGen Gold	21.0	First Eagle SoGen Gold	86.0
U.S. Global Investors Gold	20.2	Am. Cent. Glob. Gold Inv.	78.6
Rydex Dynamic Vent. 100	18.3	Monterey OCM Gold	74.5
ProFunds UltraShort OTC	18.1	USAA Prec. Mets. & Mins.	71.9
Laggards		Laggards	
Potomac Internet Plus	-23.8	ProFunds UltraOTC Inv.	-68.2
ProFunds UltraOTC Inv.	-18.9	Firsthand Communications	-68.1
Firsthand Communications	-18.0	Black Oak Emerging Tech.	-66.8
Black Oak Emerging Tech.	-18.0	Pilgrim Glob. Commun. A	-65.1

GLOBAL MARKETS

	Feb. 13	Week
S&P Euro Plus (U.S. Dollar)	1010.9	2.9
London (FT-SE 100)	5153.9	1.6
Paris (CAC 40)	4364.5	2.1
Frankfurt (DAX)	4935.4	2.7
Tokyo (NIKKEI 225)	9968.4	5.2
Hong Kong (Hang Seng)	10,832.7	1.3
Toronto (TSE 300)	7561.4	0.9
Mexico City (IPC)	6715.6	-1.0

FUNDAMENTALS

	Feb. 12	WK
S&P 500 Dividend Yield	1.41%	1
S&P 500 P/E Ratio (Trailing 12 mos.)	61.5	56
S&P 500 P/E Ratio (Next 12 mos.)*	20.7	20
First Call Earnings Revision*	-0.46%	-1

*First Call Corp.

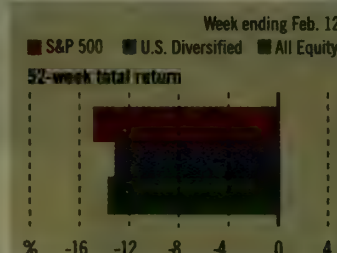
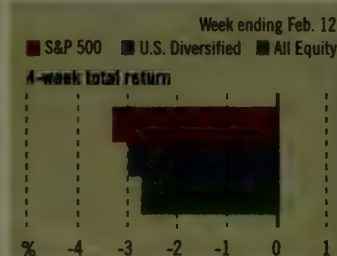
TECHNICAL INDICATORS

	Feb. 12	WK
S&P 500 200-day average	1161.6	1165
Stocks above 200-day average	58.0%	55
Options: Put/call ratio	0.82	0.7
Insiders: Vickers Sell/buy ratio	2.87	2.3

WORST-PERFORMING GROUPS

Wireless Services	-26.4	Multi-Utilities
Multi-Utilities	-25.0	Computer Stge.
Environmental Services	-23.6	Telecomms. Equip.
Electrical Equipment	-16.9	Wireless Services
Internet Software	-16.7	Instrumentation

Mutual Funds



Data: Standard & Poor's

Interest Rates

KEY RATES	Feb. 13	Week
MONEY MARKET FUNDS	1.60%	1.63%
90-DAY TREASURY BILLS	1.74	1.73
2-YEAR TREASURY NOTES	3.03	2.95
10-YEAR TREASURY NOTES	4.99	4.92
30-YEAR TREASURY BONDS	5.45	5.37
30-YEAR FIXED MORTGAGE†	6.85	6.81

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr bond
GENERAL OBLIGATIONS	4.26%
TAXABLE EQUIVALENT	6.17
INSURED REVENUE BONDS	4.42
TAXABLE EQUIVALENT	6.41

THE WEEK AHEAD

NEW RESIDENTIAL CONSTRUCTION Tuesday, Feb. 19, 8:30 a.m. EST ► Housing starts in January probably rose 0.6%, to an annual rate of 1.58 million, from 1.57 million in December. That's based on the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies.

CONSUMER PRICE INDEX Wednesday, Feb. 20, 8:30 a.m. EST ► Consumer prices for goods and services are projected to have increased 0.2% in January, after falling

0.2% in December. Excluding food and energy, core prices probably increased by the same 0.2% during January, after inching up 0.1% last month.

INTERNATIONAL TRADE Thursday, Feb. 21, 8:30 a.m. EST ► The trade deficit probably widened to \$28.2 billion in December on an increase of imports. In November, the deficit was \$27.9 billion.

LEADING INDICATORS Thursday, Feb. 21, 10 a.m. EST ► The Conference Board's

January composite index of leading economic indicators probably rose and would be the fourth increase in

FEDERAL BUDGET Thursday, Feb. 21, 8:30 a.m. EST ► The U.S. Treasury is likely a January surplus of \$39 billion compared with a \$76.4 billion surplus in January and a \$26.6 billion surplus in December. A decline in tax revenue and an increase in government expenditure could cause a deficit in excess of \$100 billion during fiscal year 2002.

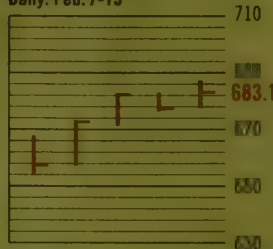
BusinessWeek Fifty

THE
BUSINESSWEEK **50**

Aug.

Feb.

Daily: Feb. 7-13



4.1% as investors regained some confidence in the companies and their outlook. Shares of Procter & Gamble rocketed 40.6% after the credit-card issuer announced regulators had approved a plan to provide more liquidity in its loans. Tyco International rose as well, as hopes grew that it will sell rather than spin off. And battered Calpine recovered 17.4%, though it's down 82.1% since March 2001.

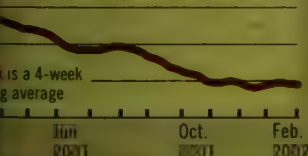
COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
National	11.5	-47.1	26	Verizon Communications	4.4	-6.5
Petroleum	0.9	-23.6	27	Citigroup	3.1	-6.8
	17.4	-82.1	28	Sun Microsystems	2.3	-51.2
	9.2	-50.5	29	Merck	3.3	-24.0
Materials	7.4	5.8	30	El Paso	10.3	-46.9
Financial	40.6	-91.1	31	Altera	1.0	-7.7
Petroleum	-0.9	6.2	32	Marsh & McLennan	6.4	1.5
	3.8	-6.6	33	Household International	16.6	-10.7
	1.5	-17.6	34	ChevronTexaco	-0.9	-5.1
Others Holdings	0.5	-24.6	35	SBC Communications	6.6	-19.2
	1.8	-10.7	36	Mercury Interactive	6.8	-36.5
	-0.1	-66.2	37	AOL Time Warner	11.9	-38.2
	1.1	-81.7	38	Washington Mutual	6.6	0.0
Laboratories	3.6	21.6	39	General Dynamics	0.4	31.7
Financial	7.5	-18.5	40	Comcast	5.3	-22.3
Technology	6.3	8.7	41	Morgan Stanley Dean Witter	5.0	-19.3
	-4.2	-7.3	42	Tellabs	2.9	-68.7
Energy	4.4	-11.0	43	Exxon Mobil	-0.7	-5.1
Chemicals	8.4	-15.8	44	Scientific-Atlanta	-4.2	-49.4
Telecommunications	2.5	-62.4	45	U.S. Bancorp	2.6	-14.0
Financial	9.7	-12.6	46	Paychex	1.9	-9.9
Petroleum	-1.1	7.5	47	Merrill Lynch	8.0	-18.8
Services	-1.0	-1.4	48	Bed Bath & Beyond	5.6	40.5
Services	-0.5	-25.5	49	Texas Instruments	11.6	1.6
Health	5.8	0.5	50	Teradyne	10.1	7.4

Production Index

Change from last week: -0.2%
Change from last year: -11.1%

AL OUTPUT Feb. 2=158.9 1992=100



The index declined for a second consecutive week. The production index of the four-week moving average slipped to 157.9, from 158.5. On a seasonal basis, the energy components of electric, oil refining, and coal, along with food, declined on the week. A mild winter in the country has curbed energy demands for power, truck assemblies, lumber, and steel increased.

For more information on the index components is at www.businessweek.com.
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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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new product line. Provides management with monthly reports setting out
market trends both domestically and worldwide for prospective wholesale
and retail customers. Promotes product lines at domestic and international trade
shows and other buyer related events to develop new customers. Works with
management to establish effective product advertising plans. Reviews sales
statistics in order to advise management as to new product feasibility.
8 years grade school; 4 years high school; 6 years of college: Master's Degree
in Business Administration; no minimum training required; 2 years experience
in job offered or 2 years experience as Assistant Marketing Manager. Shall
supervise 2 employees.
Must show proof of legal authority to work in the U.S. Applicants should send
resumes to:
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401 South State Street - 7 North, Chicago, Illinois 60605
Attention: Brenda Kelly, Reference #V-IL 25219-K
An employer paid ad. No calls.
Send 2 copies of both resume & cover letter.

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THE WRATH OF THE INVESTOR CLASS

There's an unusual kind of mass protest going on in America. A new investor class feels betrayed by the financial manipulation, managerial arrogance, and political connivance now revealed to be widespread in the aftermath of Enron Corp.'s collapse. These investors are educated, suburban, married, well-off, white- and blue-collar workers who placed their trust and their future in the stock market in the 1990s. They eagerly embraced the high-risk, high-growth economy of deregulated markets and individual choice and now feel deceived by insiders who hid the truth and rigged the odds against them.

The credibility of the populist capitalism created in the '90s may be at risk as investors ponder their future participation. Sensing that, Wall Street and Washington are racing to clean up the mess. Time is short. The investor class is taking its revenge by crushing certain stocks and pummeling companies. This is all to the good, as the market strives to cleanse itself. But if investors lose their faith in stocks and pull out in a big way, they could seriously hurt the economic recovery.

A new American social contract arose in the past decade as millions tied their future to the stock market. They exchanged their sweat equity from working 10- and 12-hour days for options, bonuses, and 401(k)s that tracked their own companies' stock and the market in general. It was a high-risk, high-reward deal promoted widely in the era by corporate executives, Wall Street firms, Republicans, New Democrats, the business press, and management gurus. The idea—a good one—was for the economy to grow more rapidly as rising stock prices generated higher capital investment, greater productivity, more jobs, and bigger incomes. Those who most avidly supported the social contract, the new investors, liked the idea of being in control of their lives, of having choices and the freedom to invest. This vision was, after all, an analogue of the American frontier dream of independence, individual responsibility, opportunity, and striking it rich.

A STACKED DECK

The betrayal that class now feels comes not from the two-year bear market that followed the booming '90s nor the bursting of the tech bubble. Until Enron, most people waited patiently for the business cycle to turn up, as it always does. What enraged investors was the revelation that Enron executives and other corporate execs had stacked the deck against them and played by a separate set of rules. Investors were stunned to learn of CEOs using their companies as private piggy banks and getting loans to cover bad personal investments; top brass cashing in huge numbers of options without telling shareholders; and employees being locked into 401(k) plans while execs sold company stock. Investors were appalled by the extravagant behavior of these executives who bestowed upon themselves special rules and special rewards.

Then investors were shocked to discover that they had also been misled about the level of risk they had taken on by ty-

ing their futures to the market. Disclosures revealed that enormous corporate profits of the '90s were actual counting mirages. Huge writedowns and hundreds of statements wiped out billions in earnings. Off-balance partnerships turned out to have concealed enormous delinquency costs were much higher; income was lower than countants and analysts, the watchdogs of the market, unmasked as stock promoters and corporate cheerleaders, not guardians of the investor.

The final straw came when investors learned that many of the nation's politicians had betrayed them as well. Companies were able to get regulations changed in the shadow of their private benefit. Laws protecting shareholders were done by politicians, both Democrat and Republican, before corporate campaign donors.

The good news is that investor wrath has pushed the market rushing to clean things up. Companies with questionable financial statements are becoming pariahs and are straightening their books as fast as they can. Even 1-800-Kreme Doughnuts Inc. is being forced to shift \$35 million from a "synthetic lease" and back onto its income statement. Auditing is finally changing as well. The Big Five agreed to split off some of their service businesses from auditing, reversing years of opposing such action. Wall Street is taking small steps to return some credibility to its analysts. They are talking about disclosing hidden investment bank relationships in research reports and limiting stock ownership in companies that analysts cover.

WASHINGTON WEIGHS IN

Washington, terrified of angry investors as the November elections approach, is moving with unprecedented haste. Congress, the Bush Administration, and regulators are all up behind investors. The House is proposing a law to strengthen auditing standards, give more funding to the Securities & Exchange Commission to oversee corporations, and force CEOs to report company stock transactions within 24 hours. The Administration has signalled that it will take a much tougher line on accounting standards. The mission is instilling fear in corporate suites by saying that they will enforce the spirit of accounting law, not just the letter.

At a remarkable speed, the system is correcting. The financial and political clout of the investor class is making itself felt on Wall Street and in Washington. Investors will soon get better data—faster—from corporations. Chief executives will be made more responsible for their balance sheets and behavior. Boards of directors will be strengthened. There will even be a chance for campaign-finance reform. But that's not enough. If America as a nation is to reap the benefits of a high-risk, high reward economy, then individual investors must take more responsibility as well. They must learn to gauge risk and manage it. Investors appear to have learned their protest. Now they must prepare for the future.

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business.

Took care of their
families.

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leave his family with every

advantage,

while the other leaves
everything to chance?

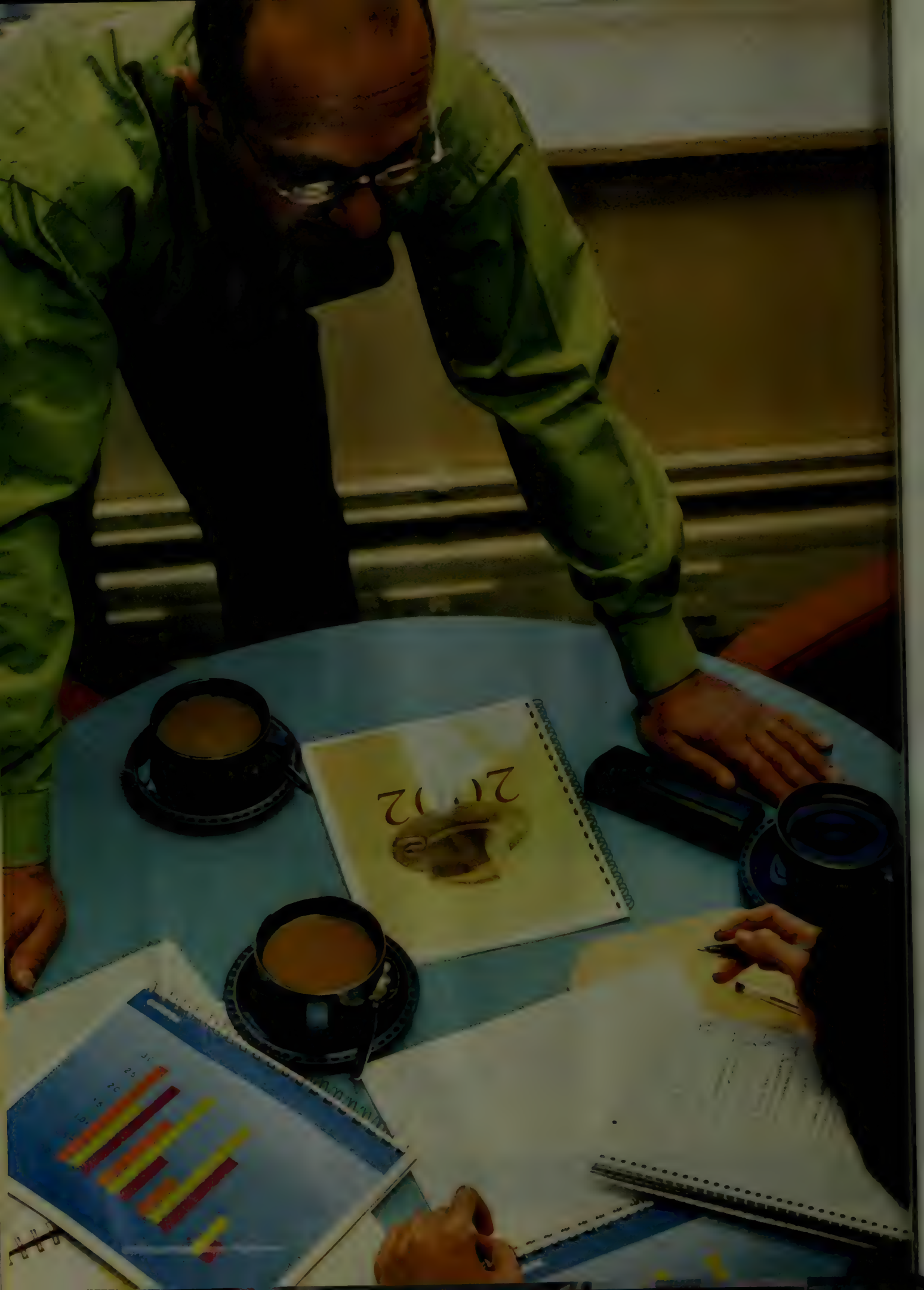


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